Merging in the Shadow of the Law: The Case for Consistent Judicial Efficiency Analysis

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INTRODUCTION

A significant gap exists between how courts say they are implementing Section 7 of the Clayton Act and what detailed case analysis reveals they are in fact doing. The purpose of the Clayton Act is to prevent mergers and acquisitions ("M&A") that may substantially lessen competition or tend to create a monopoly.\(^1\) The courts and the federal agencies responsible for enforcing the Clayton Act, however, have also expressly recognized the potential for M&A to contribute positively to competition through merger-specific efficiencies.\(^2\) These strategic synergies and cost savings—available only through the proposed merger—enable merging parties to combine to form stronger, more nimble organizations better positioned to challenge market leaders.

This Article examines twenty-five years of Section 7 Clayton Act cases in which efficiency claims were raised. The analysis reveals a disturbing pattern. Although courts claim to be balancing merger-generated efficiencies with other negative factors affecting market competition, they are not in fact doing so. Rather, courts appear to be making an assessment of the relevant concentration in the applicable market and then allowing that initial assessment to color their recognition of claimed efficiencies. In cases with limited concentration concerns, courts often cite efficiencies as factors contributing to market competitiveness. In cases involving highly concentrated

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markets, however, courts often discard similar types of efficiencies. No balancing analysis is ever performed.

Such inconsistent judicial treatment of efficiency claims has not presented a significant problem before now because antitrust enforcement has been relatively lax; the vast majority of proposed deals proceed without intervention. With the changing economic and political climate, however, antitrust policy is likely to shift towards more aggressive enforcement, including increased scrutiny of mergers and acquisitions. This impending enforcement shift, combined with the failure of courts to appropriately balance efficiencies in Section 7 cases, threatens to worsen the competitiveness of U.S. corporations and markets. Inconsistent judicial treatment of efficiencies either blocks or discourages M&A deals that could have contributed to increased competitiveness.

This Article argues that if courts do not consistently balance pro-competitive efficiencies against the other anticompetitive effects of proposed M&A deals, corporations facing stricter antitrust regimes will abandon important deals that could have contributed to the competitiveness of the U.S. economy. Part I reviews how courts currently treat efficiency claims. It highlights some key differences between how courts say they are weighing efficiency claims and what an analysis of the case law reveals they are actually doing. Part II discusses why we are likely to see a shift towards more aggressive antitrust enforcement. Part III applies several frameworks from the negotiation field, including Best Alternative to a Negotiated

3. The recent financial crisis has contributed to far greater public support for increased regulation of market activity. See Michael Schuman, Why Government Intervention Won’t Last, TIME.COM, Nov. 25, 2008, http://www.time.com/time/business/article/0,8599,1862028,00.html (arguing that the financial crisis has strengthened public support for economic regulation, but that this support is only temporary).


5. In a statement to the American Antitrust Institute during his campaign, for example, Senator Obama noted:

At home, for more than a century, there has been broad bipartisan support for vigorous antitrust enforcement, to protect competition and to foster innovation and economic growth. Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half century. As president, I will direct my administration to reinvigorate antitrust enforcement. It will step up review of merger activity and take effective action to stop or restructure those mergers that are likely to harm consumer welfare, while quickly clearing those that do not.

Agreement ("BATNA") analysis, Zone of Possible Agreement ("ZOPA") analysis, and Sources of Value analysis to demonstrate how inconsistent judicial treatment of efficiencies will reduce the volume of M&A deals and encourage corporations to abandon those deals that have the greatest potential to increase competition. Finally, Part IV proposes guidelines for how courts could incorporate efficiencies more effectively into the initial Section 7 analysis.

I. CURRENT COURT TREATMENT OF EFFICIENCY CLAIMS

Courts addressing Section 7 preliminary injunction cases generally state that they are applying an antitrust analysis similar to that outlined in the 1997 Federal Trade Commission ("FTC") / Department of Justice ("DOJ") Joint Merger Guidelines ("Guidelines"). This analysis provides a framework for evaluating Section 7 Clayton Act cases and includes the balancing of pro-competitive effects of projected efficiencies against other potentially anticompetitive effects of a proposed deal. In practice, however, a gap exists between how courts state they are treating efficiencies and the role that efficiencies actually play in court decisions. As the grid analysis in this Part illustrates, no true balancing analysis is taking place.

A. Background on Section 7 of the Clayton Act

Under Section 7 of the Clayton Act, mergers are prohibited if they either substantially lessen competition or tend to create a monopoly. Determining whether a transaction will "substantially lessen competition" can be difficult due to the predictive nature of the analyses involved. Courts, therefore, use market share measurements as a proxy for this criterion. Prosecuting agencies ("Agencies") can

6. The Agencies issued new Guidelines amending the 1997 Revisions on August 19, 2010. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), available at http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf [hereinafter 2010 REVISIONS]. However, because the courts have not yet heard a case since the release of the 2010 Revisions, this Article does not analyze the latest revisions. Further, the Efficiencies section of the 2010 Revisions is not substantively different from the Efficiencies section of the 1997 Revisions.


8. See Malcolm B. Conte, Efficiencies in Merger Analysis: An Institutionalist View, 13 SUP. CT. ECON. REV. 189, 225–26 (2005) (discussing the inherent difficulties in using neoclassical balancing analysis to assess the anticompetitive and pro-competitive efficiency effects of a proposed merger transaction).

9. Section 7 enforcement actions are generally brought by either the Federal Trade Commission, the Antitrust Division of the Department of Justice, or state attorneys general.
establish a prima facie case by demonstrating that the merged entities will control a significant portion of the relevant market, thus enabling them to raise prices above normal competitive levels.

Merging parties have the opportunity to rebut the market-share-based prima facie case by demonstrating that specific characteristics of the market in question (for example, ease of entry or sophisticated, powerful buyers) make it unlikely that the merged entities’ market position will have a negative impact on competition. Historically, although a technical rebuttal exists, once the Agencies have established a prima facie market concentration case, merging parties have had a very difficult time rebutting the presumption of a resulting negative impact upon competition. Courts have only recently begun to give much weight to any of the rebuttal factors that might mitigate the adverse effects of increased concentration.

Of all of the potential rebuttal factors, the one that has proven the most controversial is that of “efficiencies.” Companies can have many different motivations for engaging in M&A activity, including diversification, growth, international expansion, tax advantages, and.


10. Interesting issues about how to identify appropriate product and geographic market definitions often end up determining the outcome of Section 7 cases. See, e.g., FTC v. Whole Foods Mkt., 502 F. Supp. 2d 1, 34 (D.D.C. 2007) (holding that the appropriate market against which to assess the impact of a Whole Foods/Wild Oats merger was supermarkets generally, rather than the “premium natural and organic supermarket” market). These issues, however, are well beyond the scope of this Article.


12. See id. at 54 (weighing defendants’ argument that factors such as ease of entry and expansion into the market and the existence of power buyers are sufficient to rebut the Federal Trade Commission’s prima facie case that the merger would lessen competition).


14. Id. The first case in which defendants successfully rebutted the government’s prima facie market concentration case was United States v. General Dynamics, 415 U.S. 486 (1974) (holding uncommitted coal reserve levels rendered current market shares a poor metric of future competitive position). See also William J. Kolasky & Andrew R. Dick, The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers, 71 ANTITRUST L.J. 207, 214 (2003) (explaining that General Dynamics rebutted the government’s prima facie market concentration case by showing that other industry factors meant the merger would not substantially reduce competition).

15. See Piraino, supra note 13, at 791–92 (“In recent years, the courts and agencies have become increasingly willing to consider mitigating factors that may rebut the presumption of illegality for mergers in concentrated markets. Unfortunately, however, neither the courts nor the agencies have developed standards for determining, first, what mitigating factors should be deemed particularly relevant, and second, the priority or weight that should be afforded such factors. Among the most nettlesome issues has been the weight to be afforded the efficiencies likely to result from a merger.”).
market power, and simply a desire to “empire build.”16 Sometimes, however, the driving factor is projected synergies or cost savings.17 By integrating their operations, management may believe, for example, that they will be able to manufacture products less expensively, reduce the size and cost of their sales forces, or eliminate duplicative infrastructure (for example, HR departments, legal departments, or IT departments).18 Each of these efficiencies will enable the entity to operate more effectively—to produce more products and services at a lower cost.

Depending upon the specific structure of the market in question, such merger-based efficiencies could lead to increased competition in the market, despite an increased market concentration level.19 If, for example, the third and fourth largest companies in the market merge, the new combined entity may be better positioned to compete for business currently dominated by the top two organizations. The positive effect that the resulting merger efficiencies have on market competition can offset the negative effect on competition that may result from increased market concentration.

B. Conflicting Guidance from Historic Supreme Court Cases and Contemporary Agency Guidelines

Courts facing Section 7 efficiency claims today are caught between historic—and outdated20—Supreme Court cases and

16. See Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings 117–68 (2d ed. 2007) (discussing companies’ reasons for engaging in merger and acquisition activities); Alan A. Fisher & Robert H. Lande, Efficiency Considerations in Merger Enforcement, 71 CAL. L. REV. 1580, 1584 (1983) (pointing out that during the 1960s economists and lawyers often thought that the goals of mergers were unrelated to efficiencies).


19. See Coate, supra note 8, at 218 (arguing that the efficient merger of two smaller firms can give rise to a stronger competitor).

20. As Herbert Hovenkamp has noted:

[Merger] law is the largest area of public antitrust enforcement activity, and an area where the law as the Supreme Court last left it is indefensible. While antitrust casebooks continue to print 1960s-vintage merger decisions that have never been overruled, no one, not even federal judges and certainly not the government enforcement agencies, pay much attention to them.

contemporary Agency antitrust policy. The Supreme Court has not directly addressed a Section 7 Clayton Act case on the merits in over thirty years. In part, this is due to the passage of the Hart-Scott-Rodino Act (‘‘HSR’’) in 1976. HSR, and its pre-merger notification requirements, reduced the number of mergers the court system reviews; instead, most cases are now handled at the Agency level.

The historic Supreme Court Section 7 cases were decided during a time period when (1) mergers were treated with greater suspicion than today, (2) very few economic tools existed to aid judges in understanding the actual impact of a proposed deal, and (3) the Court considered the protection of small businesses to be an additional underlying goal of antitrust policy. Given this context, it is understandable that almost all of the early Supreme Court cases ended up ruling against the merger.

In 1990, when reviewing Section 7 Supreme Court cases, the D.C. Circuit noted critically:

21. Donna E. Patterson, Antitrust Enforcement in the Clinton Administration, ANTITRUST, Summer 2001, at 70, 72. Note that in 1990, the Supreme Court did rule on a Section 7-related matter in which it considered the issue of whether divestiture is a form of injunctive relief available through Section 16 of the Clayton Act. Although the underlying claim did involve a Section 7 issue, the Supreme Court only narrowly considered the Section 16 divestiture question. See California v. Am. Stores Co., 495 U.S. 271, 282 (1990) (holding that the plain text of Section 16 of the Clayton Act authorizes divestiture as a form of injunctive relief).

22. SULLIVAN & GRIMES, supra note 9, at 579. See also Patterson, supra note 21, at 72 (noting that an unintended consequence of the Hart-Scott-Rodino Act’s premerger notification requirement has been a decrease in the number of merger cases that are litigated, because once parties are informed that federal agencies plan to challenge a proposed merger, they typically abandon the transaction).


24. See Werden, supra note 20, at 73–74 (“With respect to Section 7 of the Clayton Act, Supreme Court jurisprudence is totally out of touch with developments in economics and agency enforcement because the Court has not considered the merits of a merger case for more than three decades.”).

25. See SULLIVAN & GRIMES, supra note 9, at 557 (explaining that in United States v. Von’s Grocery Co., 384 U.S. 270 (1966), the Supreme Court’s decision to strike down a merger of two retail grocery store chains that collectively held 8.9 percent of the market was based on the Court’s desire to protect small businesses).

In the mid-1960s, the Supreme Court construed section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be.27

During this time period, the Supreme Court never directly addressed the issue of an “efficiency defense”; therefore, no specific precedent exists stating whether potential pro-competitive efficiencies should be included in the Section 7 competitive impact analysis.28 Some of the language from these early cases, however, is fairly hostile to the concept of an efficiency defense. For example, in Brown Shoe Co. v. United States, the Court stated, “[W]e cannot fail to recognize Congress’ desire to promote competition, through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization.”29

A year later in United States v. Philadelphia National Bank, the Court noted:

We are clear, however, that a merger the effect of which “may be substantially to lessen competition” is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial . . . . Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.30

Finally, in 1967 in Federal Trade Commission v. Proctor & Gamble Co., the Court most directly stated, “Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.”31 Although this language comes very close to rejecting the efficiency defense outright, scholars have identified various reasons why a narrow interpretation of this statement is appropriate.32

30. Phila. Nat’l Bank, 374 U.S. at 371. Note that some commentators believe that this language referenced other benefits that the transaction would bring to the community and not specific corporate efficiencies. Muris, supra note 28, at 409.
32. See Kolasky & Dick, supra note 14, at 211 (noting the Court’s hostility in Proctor & Gamble towards an efficiency defense). Reasons why one should not interpret the Court in Proctor & Gamble as explicitly rejecting the efficiency defense include: (1) the context of the
At times, Supreme Court dicta from these older cases goes even a step further, implying that not only should efficiencies not be recognized as a positive merger benefit, but also revealing that they were actually considered to be a negative consideration.\textsuperscript{33} Supreme Court Justices feared that merger-generated efficiencies would give the new combined organization an unfair advantage against smaller, existing businesses.\textsuperscript{34} It is unlikely that the Supreme Court of this earlier era would have validated the type of efficiencies claims being made today.

In stark contrast to this hostile view of mergers and efficiencies, recent Agency actions and guidelines explicitly recognize the potential positive, pro-competitive impact of merger-generated efficiencies. The FTC and the Antitrust Division of the DOJ hold concurrent jurisdiction for prosecuting Section 7 Clayton Act claims.\textsuperscript{35} Over the years, their publicly released Guidelines have slowly acknowledged and incorporated efficiencies into the analysis of the competitive effects of horizontal mergers.

Courts assessing Section 7 efficiency claims today face an interesting situation. Although the early Supreme Court cases were clearly hostile to efficiency claims, the Guidelines and recent Agency actions have been more supportive.\textsuperscript{36} Unfortunately, the legislative history of Section 7 does not clarify whether, or to what extent, Congress expected courts to consider potential efficiencies in Section 7

\textsuperscript{33} Robert Pitofsky, \textit{Efficiency Consideration and Merger Enforcement: Comparison of U.S. and EU Approaches}, 30 \textit{Fordham Int'l L.J.} 1413, 1416 (2007) (“The treatment of efficiencies in the United States began with a notable misstep. In 1962 in \textit{Brown Shoe Co. v. United States}, the U.S. Supreme Court, in the first merger case it considered after the Clayton Act was thoroughly revised in 1950 to augment governmental power to challenge mergers, concluded that efficiencies realized in mergers could weigh against the legality of a merger.”).

\textsuperscript{34} In 1969, Oliver Williamson noted that, “[a]s things stand now, we observe the regrettable condition in which a company proposing a merger, an apparent effect of which is to realize economies, consciously suppresses the economies aspect lest it be used affirmatively by the government to attack the merger.” Oliver E. Williamson, \textit{Allocative Efficiency and the Limits of Antitrust}, \textit{AM. ECON. REV.}, May 1969, at 105, 113. In \textit{Brown Shoe Co.}, the first Section 7 case heard by the Supreme Court under the amended Clayton Act, the government actually argued that the merger was anticompetitive because it would allow the company to \textit{lower} prices due to efficiencies gained through vertical integration. In a strange twist, the defendants actually denied that the merger would generate any efficiencies. Muris, \textit{supra} note 28, at 403–04.

\textsuperscript{35} \textit{Sullivan & Grimes, supra} note 9, at 574–75.

\textsuperscript{36} 1997 \textit{Revisions, supra} note 2, § 4 (“Efficiencies generated through merger can enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.”).
Clayton Act cases. The discussions that took place prior to the 1950 amendments to Section 7 focused on the negative competitive impacts of increased market concentration levels; they did not squarely address the issue of whether, or how, efficiencies resulting from a merger should be considered in the analysis.

C. How the Courts SAY They Are Treating Efficiency Claims

Although it is not binding authority, lower courts generally say that they are applying antitrust analysis consistent with the Guidelines framework when analyzing Section 7 cases and efficiency claims. The Guidelines state that

[t]he Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable


38. Pitofsky, supra note 37, at 211–12. In the legislative history, there was a committee report that noted that the statute was not meant to prevent two small companies from merging to compete more effectively with a larger rival. Id. at 212 (noting that if Congress had analyzed this example, they would have recognized it as a narrow application of the Efficiency Defense); see also Fed. Trade Comm’n, Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace ch. 2, p. 4 (1996), available at http://www.ftc.gov/opp/global/report/gc_v1.pdf [hereinafter ANTICIPATING THE 21ST CENTURY] (“The legislative history of Section 7 of the Clayton Act does not expressly address efficiencies or whether efficiencies could be evaluated in a Section 7 action. Neither the Supreme Court nor any lower court nor the Federal Trade Commission has ever interpreted the legislative history as expressly requiring or absolutely foreclosing a consideration of efficiencies in a merger analysis under Section 7.”).

39. See FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 37 (D.D.C. 2009) (“Thus, an analysis of the likely competitive effects of a merger requires determinations of (1) the relevant product market, (2) the relevant geographic market, and (3) the transaction’s probable effect on competition in those markets . . . . Under the Federal Trade Commission and U.S. Department of Justice Horizontal Merger Guidelines, a market with a post-merger HHI above 1800 is considered ‘highly concentrated,’ and mergers that increase the HHI in such a market by more than 100 points ‘are presumed . . . likely to create or enhance market power or facilitate its exercise.’ Although the Merger Guidelines are not binding on the Court, they provide a ‘useful illustration of the application of HHI’’); id. at 39 (“The Merger Guidelines recognize that ‘mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction.’ Although the Supreme Court has not sanctioned the efficiencies defense in Section 7 cases, ‘the trend among lower courts is to recognize the defense.’”).
efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market.\footnote{1997 Revisions, supra note 2, \S\ 4.}

The Guidelines expressly outline that a balancing approach be taken, with potential pro-competitive efficiencies balanced against other potential anticompetitive impacts of the merger.\footnote{Id. ("The greater the potential adverse competitive effect of a merger—as indicated by the increase in the HHI and postmerger HHI from Section 1, the analysis of potential adverse competitive effects from Section 2, and the timeliness, likelihood, and sufficiency of entry from Section 3—the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive.")}. This balancing is clearly a difficult task, as both the “pro-competitive” and “anticompetitive” impacts are projections.\footnote{See A.E. Rodriguez & M.B. Coate, Merger Pitfalls in Practice: Three Case Studies, 20 U. PA. J. INT’L ECON. L. 793, 798 (1999) ("The evaluation of the likely competitive effects of a proposed merger or acquisition is one of the more complicated tasks facing antitrust regulators because almost all of the analysis is, by necessity, forward-looking.").} Furthermore, the impacts—both positive and adverse—are generally based on economic models of predicted behavior, rather than allegations of specific, illegal behavior, such as price-fixing.\footnote{In recent years, both the FTC and DOJ have increasingly relied on “unilateral effects’ theories” to block M&A deals. Piraino, supra note 13, at 804. The basic idea is that dominant firms with large market shares can affect market price unilaterally, without needing to explicitly or tacitly collude with other competitors. See id.} The Guidelines also state that efficiencies are most likely to impact decisions in situations where the anticompetitive effects are not "great."\footnote{See 1997 Revisions, supra note 2, \S\ 4 ("In the Agency’s experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly.").}

The lower courts typically use market concentration figures, as calculated by the Herfindahl-Hirschman Index (‘HHI’), as a starting point to determine whether a merger raises potential anticompetitive issues. The HHI of a market is calculated by taking the sum of the squares of all of the competitors’ market shares in the industry.\footnote{Id. \S 1.5. For example if ten firms exist, each with ten percent market share, the HHI for the market will be 1,000 (10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2). In contrast, if one firm has ninety-one percent of the market and the other nine firms each have one percent market share, the HHI will be 8,290 (8,281 (91^2) + 9 for the other 9 firms that have 1 percent share each). A market dominated by a monopoly would have an HHI of 10,000 (100 x 100).} The Guidelines broadly divide markets into three basic categories: unconcentrated (HHI below 1,000), moderately concentrated (HHI 1,000 to 1,800), and highly concentrated (HHI above 1,800).
between 1,000 and 1,800), and highly concentrated (HHI above 1,800). 46

For each category, the Guidelines outline basic assumptions about the impact that potential mergers will have on market dynamics. For example, in moderately concentrated industries, mergers that raise the HHI by more than 100 points will “potentially raise significant competitive concerns”; in highly concentrated industries, mergers that raise HHI by more than 100 points are presumed “likely to create or enhance market power or facilitate its exercise.” 47 Against this rather concrete and specific measurement, courts attempt to balance other factors, such as ease of entry, buyer concentration, and potential efficiencies, to assess whether the overall impact of the merger will be anticompetitive.

Balancing these other, more subjective, factors against specific HHI concentration figures can be difficult. 48 Yet, this balancing analysis is extremely important. Not only does it help courts determine the projected impact of any particular merger, but also it creates precedent as to how courts weigh specific efficiencies against other potential anticompetitive effects of proposed deals. This precedent is extremely important to potential acquirers as companies assess whether a particular deal will likely raise Section 7 concerns.

D. How the Courts ARE Treating Efficiency Claims

There is a significant gap between how courts state that they are treating efficiency claims and how projected synergies are actually being incorporated into courts’ decisionmaking processes. Courts do not appear to be engaging in any true balancing of the pro-competitive effects of efficiencies versus other anticompetitive aspects of a proposed deal. Instead, case analysis demonstrates that they first make a determination regarding market concentration levels and then allow that analysis to color their assessment of the associated efficiencies.

In situations involving lower levels of market concentration, courts have recognized significant merger-generated efficiencies. In cases involving higher market concentration, however, the courts have discarded similar types of efficiencies as non-cognizable.

46.  Id. The 2010 Guidelines adjusted the ranges for HHI categories: unconcentrated (HHI below 1500), moderately concentrated (HHI between 1,500 and 2,500, and highly concentrated (HHI above 2500). 2010 REVISIONS, supra note 6, § 5.3.
47.  Id. § 1.51.
48.  See Coate, supra note 8, at 225–26 (noting that balancing these factors would require a multistep analysis).
Courts apply three criteria to determine whether efficiencies will be recognized: (1) verifiability—whether the efficiency claims are supported by data, (2) merger specificity—whether the efficiencies could be achieved through other less restrictive means, and (3) consumer pass-through—whether the efficiencies will ultimately benefit consumers. Few efficiency projections satisfy all three criteria.

1. Balancing of Efficiency Claims

Craig Conrath and Nicholas Widnell have observed that “[t]he difficult challenge presented by such an efficiencies defense is whether there is a coherent way to balance the potential anticompetitive effects of a merger against its potential efficiency benefits. This question . . . has remained a perennial topic of debate among antitrust practitioners.”49 How should the courts decide whether the claimed efficiencies offset any projected anticompetitive effects of the merger?50

One significant problem with current judicial treatment of Section 7 efficiency claims is that the recognition of efficiencies is lopsided. In 1999, prior to his term in office, former FTC Chairman Timothy Muris observed a similar pattern with Agency decisions.

Too often, the Agencies found no cognizable efficiencies when anticompetitive effects were determined to be likely and seemed to recognize efficiency only when no adverse effects were predicted. Thus the Agencies tended to reach a conclusion on likely anticompetitive effects of a merger, a decision that influenced their conclusions regarding efficiencies.51

In other words, the Agencies appeared to be first coming to a conclusion on anticompetitive effects—without considering efficiencies—and then allowing that decision to impact their assessment of efficiencies.

Unfortunately, the troubling Agency pattern that Timothy Muris observed in 1999 is now clearly discernable in courts’ treatment of Section 7 efficiency claims as well. With the exception of some hospital mergers, courts recognize substantial efficiencies only in cases with limited projected anticompetitive effects. In cases in which

50. See Paul Rogers, The Limited Case for an Efficiency Defense in Horizontal Mergers, 58 TUL. L. REV. 503, 540 (1983) (“The ultimate question is what amount of efficiency gain will offset what amount of increased market power.”). Conceptually, this may not seem too difficult an idea to grasp. The issues arise, however, when courts attempt to move from the realm of theoretical concepts to concrete, real market assessments.
anticompetitive impacts are more likely, courts are shying away from any true balancing. Instead, they simply declare the claimed efficiencies in these cases to be insubstantial or unverifiable.

2. The Grid Analysis: A Bimodal Pattern

An analysis of all available Section 7 preliminary injunction cases involving efficiency claims over the past twenty-five years confirms the view that courts are not performing any true balancing analysis. The twenty-three cases analyzed span a broad range of industries including tank ammunition, baby food, supermarkets, coal mining, wholesale prescription drugs, wagering software, aircraft transparencies, gasoline, fluid milk processing, food service glassware, enterprise resource planning software applications, and office supplies. Seven of the twenty-three cases involved hospital mergers. The cases took place between 1986 and 2009. Approximately half were heard in either the D.C. District Court or the D.C. Court of Appeals; the rest were spread among many different jurisdictions.

In fourteen of the twenty-three cases (sixty-one percent) the Agencies successfully obtained a preliminary injunction to block the intended merger transaction. In the other nine cases, the court held that there was not enough evidence of negative competitive effect to justify a preliminary injunction. Interestingly, an analysis of the cases based on market concentration alone does not fully explain the court rulings. The following charts provide the full citations for each case and classify the twenty-three cases based on the level of underlying market concentration.52 Although preliminary injunctions were issued in the majority of cases involving high market concentration, they were not issued in all of the cases. Furthermore, the cases involving medium market concentration were split in terms of outcome. The level of market concentration clearly contributes to the court’s decision, but it does not explain the whole story.

52. For purposes of this analysis, markets were categorized as having “high” concentration levels if the court recognized a resulting HHI from the merger transaction of over 3,000. “Medium” concentration categorization represents transactions that would result in HHI market concentration levels of 2,000–3,000. Those cases categorized as having “low” concentration levels generally involved situations where the court felt that the Agencies failed to define a narrowly focused geographic and product market resulting in any significant level of market concentration.
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Full Citations for Cases Analyzed


United States v. Country Lake Foods, Inc.,

United States v. Carilion Health System,

United States v. Long Island Jewish Med. Ctr.,

Federal Trade Commission v. Arch Coal,

Federal Trade Commission v. Foster W. Ref., Inc.,
2007 WL 1793441 (D.N.M. June 11, 2007).

Federal Trade Commission v. Tenet Health Care Corp.,
186 F.3d 1045 (8th Cir. 1999).

Federal Trade Commission v. Swedish Match,


998 F.2d 1206 (11th Cir. 1991).

Federal Trade Commission v. Alliant Techsystems,

Federal Trade Commission v. H.J. Heinz Co.,
246 F.3d 708 (D.C. Cir. 2001).

Federal Trade Commission v. PPG, Indus.,
798 F.2d 1500, 1508 (D.C. Cir. 1986).

Federal Trade Commission v. Libbey, Inc.,

United States v. United Tote, Inc.,

Federal Trade Commission v. CCC Holdings, Inc.,

United States v. Rockford Mem’l Corp.,

Federal Trade Commission v. Staples, Inc.,

United States v. Franklin Elec. Co.,
130 F. Supp. 2d 1025 (W.D. Wis. 2000).

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697 F. Supp. 1125 (C.D. Cal. 1988), aff'd in part and rev'd in part on other grounds, 872 F.2d
837 (9th Cir. 1989), rev'd on other grounds, 495 U.S. 271 (1990).

Federal Trade Commission v. Ill. Cereal Mills,

United States v. Mercy Health Servs.,
902 F. Supp. 968 (N.D. Iowa 1995), dismissed as moot, 107 F.3d 632 (8th Cir. 1997).

United States v. Oracle Corp.,
331 F. Supp. 2d 1098 (N.D. Cal. 2004).
Table 1: Market Concentration Analysis

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<th>Concentration</th>
<th>Low (HHI &lt; 2,000)</th>
<th>Medium (HHI 2,000–3,000)</th>
<th>High (HHI &gt; 3,000)</th>
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<td>Preliminary injunction</td>
<td>Am. Stores</td>
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<tr>
<td>No preliminary injunction</td>
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<td>Carilion Health</td>
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A similar analysis focusing solely on recognized efficiencies appears to better explain judicial decisions, but still fails to tell the whole story. In the following table, the twenty-three cases are characterized based on the level of efficiencies the court recognized. Cases are characterized as having “high” efficiencies if the court identified the merger as generating significant efficiencies, “medium” if the court recognized that the transaction would generate some efficiencies, and “low” if the court discounted the projected efficiencies altogether due to concerns over verifiability, merger specificity, or consumer pass-through. Appendix I at the end of this Article contains a detailed analysis of the data supporting the market concentration and efficiency levels identified in Tables 1 and 2.

As Table 2 demonstrates, there appears to be a fairly strong correlation between recognized efficiencies and court decisions regarding whether to issue a preliminary injunction (that is, in cases where the court identified either “medium” or “high” efficiencies, no preliminary injunction was granted); however, the outcomes for cases involving “low” efficiencies are still mixed.
Only by superimposing the two variables (market concentration and efficiencies) together in the same chart, does the pattern of judicial decisionmaking become clear. As Table 3 demonstrates, the combination of court-recognized market concentration and transaction-related efficiencies correlates perfectly with the holdings in all twenty-three cases. All cases with the same combination of factors (that is, the same level of market concentration and recognized efficiencies) result in the same court holding. In Table 3, cases listed in the shaded blocks are those that resulted in preliminary injunctions. Those in the other blocks of the grid did not. As the grid demonstrates, all cases involving low-recognized efficiencies and either medium or high market concentration levels resulted in preliminary injunctions. All other cases did not. There are no mixed blocks in the grid.
Table 3: Market Concentration & Efficiencies

<table>
<thead>
<tr>
<th>Concentration</th>
<th>Low (HHI &lt; 2,000)</th>
<th>Medium (HHI 2,000–3,000)</th>
<th>High (HHI &gt; 3,000)</th>
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<td>High</td>
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<td>Low</td>
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= Preliminary Injunction Issued

Table 3 appears to provide data demonstrating robust, sophisticated, and consistent judicial treatment of these Section 7 cases. No one variable explains the case holdings. The pattern of judicial decisionmaking is only revealed when multiple criteria are considered and the courts appear to have treated “like” cases similarly. There is, however, a problem with this interpretation.

The courts’ rulings are perfectly correlated with the levels of identified market concentration and recognized efficiencies. Table 3 categorizes the cases based on these two “input” factors. Given the number of cases heard over the last twenty-five years, one would expect to see a broad array of input combinations on the grid (for example, cases involving high market concentration and high efficiency levels, low concentration and medium efficiency levels, medium market concentration and high efficiency levels). If there were any selection bias for the input factors of these cases, it would
logically tip the balance in favor of the “close calls,” as the cases most likely to proceed with litigation would be ones, for example, with high market concentration and high efficiency levels.

The data, however, reveal a completely different picture. A bimodal pattern appears in the opposite direction of what the selection bias would predict. Recognition of high levels of efficiencies generally only occurs in cases where concentration levels are relatively low. Similarly, almost all cases that involved high concentration levels involved low recognized levels of efficiencies. The only cases not to consistently follow this pattern involve hospital mergers. In these cases, the non-profit nature of the organizations merging appears to affect courts’ recognition of efficiencies. In almost all other cases, courts only recognized significant efficiencies in situations where they had already determined that the merger did not substantially increase market concentration.

53. See, e.g., FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1302 (W.D. Mich. 1996) (“Of critical importance in the Court’s evaluation of the evidence, as detailed above, are the following considerations. First, nonprofit hospitals operate differently in highly-concentrated markets than do profit-maximizing firms. Second, the boards of these two hospitals are comprised of prominent community and business leaders whose employees depend on these facilities for services, and who have demonstrated their genuine commitment to serve the greater Grand Rapids community through their governance of the hospitals . . . . Fifth, substantial cost-savings and efficiencies would be realized as a result of the merger.”).
Table 4: The Bimodal Pattern—All Cases

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<th>Concentration</th>
<th>Low (HHI &lt; 2,000)</th>
<th>Medium (HHI 2,000–3,000)</th>
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Although courts have recognized significant efficiencies related to production economies of scale, operational efficiencies from spreading administrative costs over a broader organization, capital avoidance, and improved quality of services, they have only done so in situations where the associated merger did not create market concentration concerns. In cases where mergers did create market

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55. See, e.g., United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 148 (E.D.N.Y. 1997) (acknowledging the possibility of cost sharing among the hospitals that propose to merge, but remaining unconvinced that it is the correct method for analyzing the potential merger).

56. Id. at 148–49 (listing capital avoidance as an efficiency created by the merger).

concentration issues, similar types of efficiencies were almost always discredited.\textsuperscript{58}

This pattern is even more noticeable when the transactions involving hospital mergers are removed from the analysis.

<table>
<thead>
<tr>
<th>Concentration</th>
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Courts’ current treatment of efficiencies in Section 7 cases is troubling. Efficiencies are not being judged according to their individual merits, but rather in relationship to the other perceived anticompetitive effects of the merger. This means that identical sets of predicted efficiencies could be treated very differently in two different mergers.

It would be theoretically sound to find that a set of projected efficiencies justifies a merger in one context, but not in another due to the other anticompetitive effects of the deal, as long as this determination took place during the balancing portion of the analysis.

Unfortunately this is not what is currently occurring in the courts. Different merger contexts appear to be influencing whether the courts recognize the efficiencies in the first place. In situations without significant anticompetitive risks, courts are recognizing projected efficiencies as valid. In situations with competitive concerns, similar efficiencies are being characterized as unverifiable.

3. Recognition of Efficiency Projections

Courts use three main criteria to disregard efficiencies: verifiability, merger specificity, and ultimate consumer pass-through. The verification requirement has proven extremely challenging for companies to meet.\(^5\) Merging companies must “substantiate” claims so they can be “verified.”\(^6\)

By definition, efficiency claims are based on future predictions, which makes it easy for courts to discount them as too vague and speculative.\(^7\) Information asymmetries contribute to the problem. Merging entities have sole possession of documents and information relating to projected efficiencies.\(^8\) Courts understandably hesitate to

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59. See, e.g., FTC v. Univ. Health Inc., 938 F.2d 1206, 1222 (11th Cir. 1991) (“Here, however, the appellees have failed to introduce sufficient evidence to demonstrate that their transaction would yield any efficiencies, and the district court’s factual finding to the contrary is clearly erroneous.”); Coate, supra note 8, at 230–31 (“Based on the review of the recent court cases (and abstracting from the hospital mergers), it would appear that the efficiency defense faces an impossibly high burden which as a practical matter, virtually precludes the operationalization of the efficiency defense.”).

60. Specifically, the 1997 Revisions state:

\[\text{The merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means.}\]

1997 Revisions, supra note 2, § 4.

61. See, e.g., FTC v. Swedish Match, 131 F. Supp. 2d 151, 172 (D.D.C. 2000) (“Without significantly more evidence to substantiate the savings purported in this case, and without greater clarity on the state of antitrust law in this circuit, the defendants are unable to rebut the presumption here with an efficiencies defense.”). Some commentators argue that the same standard of proof should be applied to efficiencies that is applied currently to assertions that a transaction will be anticompetitive. See Malcolm B. Coate & A.E. Rodriguez, Pitfalls in Merger Analysis: The Dirty Dozen, 30 N.M. L. Rev. 227, 234 (2000) (“On balance, it seems difficult to justify a different standard of proof for merger-related efficiencies and anticompetitive effects. An analyst would be well advised to apply the same basic probability decision rule to efficiency and anticompetitive effects.”).

62. See Mark N. Berry, Efficiencies and Horizontal Mergers: In Search of a Defense, 33 SAN DIEGO L. REV. 515, 542 (1996) (“The merging firms may be the only potential source of information about the claimed efficiencies.”); Oliver E. Williamson, Economies as an Antitrust Defense Revisited, 125 U. PA. L. Rev. 699, 703 (1977) (discussing how an “information-
give much weight to this evidence, given concerns that corporations will selectively disclose information to support their efficiency claims, while ignoring data that might dampen their assertions.\(^63\) Courts also tend to be critical of corporate efficiency projections that change over time, generally growing more critical as the organization gets closer to a hearing or trial.\(^64\) Therefore, courts attach more credibility to internal corporate documents that pre-date the merger agreement or letter of intent.\(^65\)

Although it might seem reasonable to discount corporate projections that tend to fluctuate over time, the fact that a merging entity can better identify an increasing number of potential efficiencies with greater accuracy over time actually makes sense given the increased access to competitive information that is allowed the closer one gets to the close of a transaction.\(^66\) This pattern is typical and should be a source of reassurance that the transaction is proceeding normally, rather than a cause of distrust.

A second issue that arises when companies attempt to substantiate projected efficiencies relates to classification. Which types of efficiencies should count? Originally, both the Agencies and courts articulated a very narrow interpretation of efficiencies, one that
focused mainly on manufacturing economies of scale.\(^{67}\) In reality, however, a broad range of efficiencies can contribute to a company’s ability to compete in the marketplace.\(^{68}\)

In 1995, under the leadership of FTC Chairman Robert Pitofsky, the FTC launched an in-depth investigation focusing on the impact of increasing innovation and globalization on the U.S. economy.\(^{69}\) The resulting report, *Anticipating the 21st Century: Competition Policy in the New High-Tech Global Marketplace*, acknowledged the stiff competition that U.S. businesses were increasingly facing from foreign firms.\(^{70}\) During two months of hearings, witnesses suggested various ways that the FTC could adjust its competition policy to avoid hamstringing U.S. firms’ ability to compete in the new, innovation-based global economy.\(^{71}\) At the top of the suggestion list were proposals to significantly adjust the Agency’s treatment of merger-related efficiency claims.\(^{72}\)

The 1996 FTC Task Force Report acknowledged specifically that marketplace changes were demanding new skills and capabilities. “Competition has begun to focus on the dimensions of innovation, such as speed of developing, producing, and marketing improved products and the ease of responding to shifts in customer demand and supplier capabilities.”\(^{73}\) Mergers can contribute to the competitiveness of U.S. companies, not only by reducing manufacturing costs, but also through improving research and development (“R&D”), product development, marketing efforts, customer service capabilities, and other core competencies. These are factors that distinguished companies in the global marketplaces of 1996, and they will continue

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67. See, e.g., FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61 (D.D.C. 1998) (“Efficiencies are cost savings generated by the increased economies of scale which result from mergers.”). This traditional, narrow definition of efficiencies misses many of the potential ways (e.g., through R&D synergies) that a merger can position an organization to be a more aggressive, better competitor.

68. See, e.g., Coate, supra note 8, at 226–27 (“Other efficiencies will enable the creation of new markets as the reorganization generated by the merger allows the postmerger firm to serve a customer need previously precluded by high transaction costs. If these efficiencies are relevant, numerical balancing of effects becomes very difficult.”).

69. See Fed. Trade Comm’n, *Executive Summary and Principal Conclusions* 1, in *Anticipating the 21st Century* supra note 38 (explaining the FTC investigation).

70. Id. (“U.S. firms can no longer be content with besting domestic competitors; their fiercest rivals now are often foreign firms.”).

71. See id. (stating that the hearings produced suggestions on how to compact this competition).

72. See Fed. Trade Comm’n, *Anticipating the 21st Century*, supra note 38, ch. 1, at 35 (“[A]ntitrust must take special care to weed out actions that harm competition while not discouraging others that are procompetitive. For mergers, this means antitrust must give more attention to efficiencies claims than it may have previously done.”); id. ch. 2, at 11–15.

73. Id. ch. 1, at 18.
to do so in years to come. These efficiencies should also be “counted” in merger analysis.\textsuperscript{74} Unfortunately, the courts do not recognize many of the efficiencies with the greatest potential to improve an organization’s competitive position (for example, complimentary R&D or product design capabilities) as they are often difficult to verify.\textsuperscript{75}

In addition to being “verifiable,” efficiencies weighed in a Section 7 competitive analysis must also be “merger specific.” The 1997 Guidelines state that “[t]he Agency will only consider those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.”\textsuperscript{76} Cost savings and other benefits will not be credited to a merger if there are other, less anticompetitive ways to achieve the same outcome.\textsuperscript{77}

Although this may seem like a fairly straightforward and logical criterion, issues arise when courts attempt to assess this criterion. What “other” methods should be considered? What if the company could merge with a different, smaller organization, but that...

\textsuperscript{74} See id. ch. 2, at 32 ("When considering the likelihood that a transaction will create efficiencies that may affect postmerger competitive dynamics, the FTC should not foreclose examination of a potentially wide range of efficiencies (both product and process), from economies of scale and plant specialization to distributional, promotional, transactional, managerial, and innovation efficiencies that may differ from traditional efficiency claims.").

\textsuperscript{75} See, e.g., FTC v. H.J. Heinz Co., 246 F.3d 708, 723 (D.C. Cir. 2001) ("In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC’s showing was rebutted by an innovation defense."); United States v. Rockford Mem‘l Corp., 717 F. Supp. 1251, 1288–89 (N.D. Ill. 1989) ("As to qualitative benefits to consumers, the defendants proclaim that the merger of SAH and RMH will provide the Rockford community with a first class regional tertiary referral center that will eventually rival tertiary referral centers in Madison, Chicago, Milwaukee and Rochester. The defendants promise that the number, depth, and quality of services at the hospital will improve . . . . The court finds the defendants’ intention to create a state-of-the-art tertiary referral center and all its corresponding benefits in quality and community development as irrelevant for the present Sec. 7 inquiry."); Coate, supra note 8, at 231 ("Moreover, efficiencies that cannot be easily quantified are downplayed, even though these savings might really affect the marketplace. Attempts to quantify these qualitative savings simply set them up for formal rejection."); Courts generally only recognize a narrow range of efficiencies, typically in cases where the underlying merger did not present much of an anticompetitive threat. See Garza, supra note 65, at 6.

\textsuperscript{76} 1997 REVISIONS, supra note 2, § 4.

\textsuperscript{77} See, e.g., FTC v. PPG, Indus., 798 F.2d 1500, 1508 (D.C. Cir. 1986) ("Finally the district court found that a merger of PPG and Swedlow might lead to the development of more sophisticated materials and/or transparencies . . . . [T]he gains to be derived from technological cooperation are not exclusive to a PPG-Swedlow marriage; cooperation with other market participants could yield similar results without causing the same market concentration."); William J. Kolasky, Lessons from Baby Food: The Role of Efficiencies in Merger Review, ANTITRUST, Fall 2001, at 82, 86 (anticipating an argument that Heinz was neglecting other less anticompetitive measures while putting forth an efficiency defense).
entity is unlikely to be receptive to a deal? What if an R&D joint venture were possible between three organizations in the field, but it would put an organization’s critical trade secrets at risk? Should these alternatives be considered?

Fortunately, the 1997 Guidelines clarified that only those alternatives that are operationally practical, instead of simply theoretically possible, should be considered. Still, many commentators feel that the criterion ends up being used excessively to discredit efficiency claims. In particular, courts often point to the fact that companies could achieve similar efficiencies through internal growth as a reason to take projected efficiencies out of the competitive analysis. Although it is true that many companies could eventually “grow” their way into cost savings (for example, by spreading fixed costs such as manufacturing investments over a larger revenue base), internal, organic growth is typically a multi-year process that significantly delays an organization’s ability to adjust its cost base to compete more aggressively. It often does not permit an organization to gain the same level of competitive advantage that a merger could provide.

The final criterion that projected efficiencies must satisfy in order to be included in Section 7 competitive analysis is referred to as “consumer pass-through.” Any efficiencies generated from the merger transaction must directly benefit consumers. They cannot

78. Note that licensing contracts and joint ventures can sometimes provide less restrictive mechanisms for capturing efficiencies. Pitofsky, supra note 37, at 243–44.
79. See 1997 Revisions, supra note 2, § 4 (“Only alternatives that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical.”).
80. See Eleanor M. Fox, The Efficiency Paradox, in HOW THE CHICAGO SCHOOL OVERSOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST 77, 78 (Robert Pitofsky ed., 2008) (“[M]erger parties usually cannot prove that their merger is likely to produce net efficiencies that could not otherwise be achieved.”); Piraino, supra note 13, at 798 (“Requiring defendants to prove that efficiencies will be merger-specific poses several problems. The requirement allows judges, juries, and antitrust regulators to second-guess defendants’ business judgment and substitute speculation on hypothetical ‘less restrictive’ alternatives.”).
81. See FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 63 (D.D.C. 1998) (“Weighing the evidence before it, this Court finds that the Defendants have sufficiently proved that significant efficiencies would likely result from the proposed mergers . . . . However, this Court finds that evidence presented by the FTC strongly suggests that much of the savings anticipated from the mergers could also be achieved through continued competition in the wholesale industry. While it must be conceded that the mergers would likely yield cost savings more immediately, the history of the industry over the past ten years demonstrates the power of competition to lower cost structures and garner efficiencies as well.”).
82. See Berry, supra note 62, at 548 (“For example, the merger may involve a matching of resources not achievable through internal expansion.”).
83. See Vernail, supra note 37, at 134.
simply contribute to an increased profit margin for the corporation. The benefit is most simplistically articulated as a price decrease, although other impacts such as improved quality or product variety available to consumers also would fulfill this requirement.84

Interestingly, the 1997 Guidelines do not mention explicitly a consumer pass-through requirement.85 They do, however, acknowledge that efficiencies have the potential to decrease prices or increase product quality or variety;86 thus an immediate price decrease is not always expected.87 The courts, in contrast, often apply a consumer pass-through test to efficiency claims.88 The criterion is so difficult to prove that former FTC Commissioner Robert Pitofsky labeled it a “killer qualification,”89 ensuring that efficiencies will never make a difference in merger analysis.

II. THE CHANGING LANDSCAPE: INCREASED ADMINISTRATIVE SCRUTINY OF M&A DEALS

Although intellectually troubling, the courts’ inconsistent treatment of efficiency claims has not substantively affected the level

84. See Piraino, supra note 13, at 800 (“[S]ubstantial economic benefits accrue even when firms do not lower their prices after a merger. Firms may, for example, use cost savings to fund increased spending on research and development, information technology, upgrades to plant and equipment, and other productivity improvements. Such investments benefit consumers, workers, investors, and local communities, and they promote the long-run economic welfare of our entire society.”).

85. See Deborah A. Garza, Is the Past Prologue? A Comparative Analysis of the Clinton Antitrust Program and Suggestions of Changes to Come, ANTITRUST, Summer 2001, at 64, 65 (“When they were issued, the efficiencies guidelines also appeared to be significant for what they did not do. They did not explicitly require parties to prove that efficiency savings will be passed on to consumers in the form of lower prices.”).

86. See 1997 REVISIONS, supra note 2, § 4 (“Efficiencies generated through merger can enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality; or new products.”).

87. See id. (“Efficiencies also may result in benefits in the form of new or improved products, and efficiencies may result in benefits even when price is not immediately and directly affected.”)

88. See, e.g., FTC v. Univ. Health Inc., 938 F.2d 1206, 1223 (11th Cir. 1991) (“Because of these difficulties, we hold that a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and, hence, consumers.”); FTC v. Swedish Match, 131 F. Supp. 2d 151, 172 (D.D.C. 2000) (“The savings that will be passed on to the consumers in the form of lower prices in this case is at best speculative.”); United States v. United Tote, Inc., 768 F. Supp. 1064, 1084–85 (D. Del. 1991) (“The Court’s finding is guided, in part, by the reality that even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public.”).

89. Pitofsky, supra note 37, at 207.
or character of M&A activity in the United States. Over the past ten years, the low level of Section 7 enforcement activity has resulted in almost all mergers proceeding, regardless of whether they create pro-competitive efficiencies or not. The Obama Administration, however, has signaled that stricter scrutiny of deals in concentrated markets is likely. As the pendulum swings back towards more aggressive antitrust enforcement, the importance of consistent efficiency analysis grows. Unless courts include the projected impact of merger-generated efficiencies on market dynamics, future enforcement proceedings will block pro-competitive deals.

A. The Obama Administration

The U.S. economy has had a healthy rate of M&A activity over the last thirty years, despite the inattention paid to efficiencies in Section 7 cases. Efficiencies have not played a large role in court decisions regarding Section 7 preliminary injunctions, at least in part because it was not necessary for them to do so.

The George W. Bush Administration took a very permissive view of mergers and acquisitions. Only the most egregious transactions were prosecuted. In such contexts efficiencies are simply less relevant. If almost all mergers are approved, whether they create more competitive organizations or not, there is less need to identify the truly efficient deals.


91. See Jonathan B. Baker & Carl Shapiro, Detecting and Reversing the Decline in Horizontal Merger Enforcement, ANTITRUST, Summer 2008, at 29, 30 (asserting that in the past ten years U.S. merger enforcement—particularly that led by the DOJ—has become too lax).

92. See id. at 29; Robert Pitofsky, Roundtable Discussion Advice for the New Administration, ANTITRUST, Summer 2008, at 8, 10 (2008) (“With respect to mergers, I've already said that the statistics show that we are at a very low level of merger enforcement at the DOJ. The FTC is about where it usually is. I think that most lawyers think that the chance of getting a merger through review and cleared without challenge is vastly better today than it was ten years ago.”); Obama, supra note 5, at 2 (“Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half century.”).

93. See Conrath & Widnell, supra note 23, at 686 (“Thus, merger efficiencies generally have been well recognized within merger law by imposing more stringent standards for proving a merger anticompetitive; there remains, however, the issue of whether, and how, antitrust law recognizes specific efficiencies in individual cases.”). Note that this is the horizontal merger enforcement policy that some Chicago School scholars consider optimal. Id. Due to concerns about the courts’ ability to properly weigh efficiencies, as well as a general disbelief in the anticompetitive impacts of most mergers, scholars such as Richard Posner would eliminate the efficiency defense and increase the concentration levels at which mergers raise antitrust concerns. See RICHARD A. POSNER, ANTITRUST LAW 112 (1st ed. 1976). This is the direction that
shifts with each new administration.\textsuperscript{94} In particular, recent Democratic administrations have taken a more aggressive stance regarding horizontal mergers.\textsuperscript{95}

During his campaign, President Obama clearly identified that part of his agenda included “reinvigorat[ing] antitrust enforcement.”\textsuperscript{96} In a statement to the American Antitrust Institute during his campaign, then-Senator Obama noted that

[a]t home, for more than a century, there has been broad bipartisan support for vigorous antitrust enforcement, to protect competition and to foster innovation and economic growth. Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half-century. As president, I will direct my administration to reinvigorate antitrust enforcement. It will step up review of merger activity and take effective action to stop or restructure those mergers that are likely to harm consumer welfare, while quickly clearing those that do not.\textsuperscript{97}

Signs of stricter antitrust enforcement have already emerged.\textsuperscript{98} On May 11, 2009, Christine Varney, Assistant Attorney General for the Antitrust Division of the DOJ, spoke to the Center for American

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{94} See Milton Handler et al., Trade Regulation: Cases and Materials 114 (4th ed. 1997) (“There remains, however, a concern that enforcement priorities shift too sharply with each new Assistant Attorney General in charge of the Antitrust Division, Chair of the FTC, and, of course, with each new administration. Although shifts in emphasis may reflect desirable flexibility and a healthy concern about new developments, serious questions may be raised about \textit{ad hoc} case selection and sharply shifting priorities.”).
\item \textsuperscript{95} During the Clinton Administration, both agencies were more inclined to litigate merger cases. Patterson, supra note 21, at 72 (“The Clinton Administration antitrust agencies successfully brought antitrust back ‗on stage.‘”). Although the increased level of antitrust activity was at least in part due to an increased number of underlying merger transactions, the figures also reveal a more aggressive agency stance than in the prior administration. See id. at 71–72.
\item \textsuperscript{96} Obama, supra note 5, at 2.
\item \textsuperscript{97} Id.
\item \textsuperscript{98} Commentators have noted that President Obama’s appointees have leanings toward behavioral economics, which could significantly impact antitrust enforcement under the new administration. See, e.g., Neil R. Stoll & Shepard Goldfein, Obama’s FTC: Merger Analysis to Become Exercise in Hindsight?, 241 N.Y. L.J. 3, 3 (2009) (“The application of behavioral economics to merger analysis by the FTC and DOJ under Clayton Act Sec. 7 risks expanding the scope of agency review to reach transactions that were previously unassailable and imposing substantial costs without improving the predictive quality of agency merger review.”); Tamara Lytle, Obama’s New Antitrust Rules Have Big, Powerful Companies Sweating, U.S. News & World Report.com (May 20, 2009), http://politics.usnews.com/news/national/articles/2009/05/20/obamas-new-antitrust-rules-have-big-powerful-companies-sweating.html (“The Obama administration has swept away policy after policy from the Bush administration, and the top antitrust regulator, Assistant Attorney General Christine Varney, made it clear in her first speech this week that she’s coming in with a very big broom.”).
\end{itemize}
\end{footnotesize}
Progress.\textsuperscript{99} In her speech, she stressed the importance of vigorous antitrust policy, particularly in troubled economic times.\textsuperscript{100} In addition to outlining how the DOJ intends to step up enforcement efforts, Varney officially withdrew an earlier DOJ report issued under the George W. Bush Administration that outlined an extremely conservative approach to enforcing Section 2 of the Sherman Act.\textsuperscript{101} Her statements and actions made clear that the private sector should expect more aggressive antitrust enforcement in the years to come.\textsuperscript{102}

\textbf{B. The Ongoing Financial Crisis}

The research for this Article was conducted during the first twelve months of the financial crisis that began to affect the U.S. economy in 2008. This dramatic economic incident significantly affected public opinion regarding the ethics of corporate behavior. Typically, in times of economic crisis the government reduces its enforcement of antitrust policy in order to stabilize and rebuild the economy. While some could argue that this pattern has re-emerged (witness, for example, the quick approval of many bank mergers), there is reason to believe that this crisis is different.

Unlike prior financial meltdowns, the most recent crisis has been blamed, at least in part, on the lack of proper antitrust enforcement and growing market concentration in the financial sector. This theme—that the United States permitted institutions to become “too big to fail,” typically via mergers and acquisitions—is present in many of the articles and books that have been written about the


\footnotesize{100. See id. at 4 (“Thurman Arnold’s legacy of vigorous antitrust enforcement was thus a cornerstone of the New Deal’s economic agenda and a part of that era’s legacy for modern economic policy. The lessons learned from this historical example are twofold. First, there is no adequate substitute for a competitive market, particularly during times of economic distress. Second, vigorous antitrust enforcement must play a significant role in the Government’s response to economic crises to ensure that markets remain competitive.”).}

\footnotesize{101. See id. at 8 (“For these reasons, I hereby withdraw the Section 2 Report by the Department of Justice. Thus, effective today, May 11, 2009, the Section 2 Report no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act. The Report and its conclusions should not be used as guidance by courts, antitrust practitioners, and the business community.”).}

\footnotesize{102. See id. at 5 (“As antitrust enforcers, we cannot sit on the sidelines any longer—both in terms of enforcing the antitrust laws and contributing to sound competition policy as part of our nation’s economic strategy.”).}
recession. Current widespread fears of the “dangers” of big business, combined with public support for increased regulation, politically support more aggressive interpretation and enforcement of antitrust policy.

The 1997 Guidelines categorize markets with post-merger concentration levels of 1,800 or more to be highly concentrated. In these markets, the Guidelines state that transactions that increase the HHI level by fifty or more points raise significant competitive concerns. Yet, the case analysis discussed in Part I of this Article reveals that the Agencies actually bring very few cases that involve concentration levels this low. Instead the Agencies appear mainly to be pursuing preliminary injunctions for transactions that generate HHI concentration figures in the 3,000 to 4,000+ level. Interestingly, the Agencies are in a position to implement a more aggressive antitrust agenda, even without changing existing written policy. Simply enforcing the Guidelines would bring a significant shift in M&A regulatory activity.

C. The Grid Analysis Revisited

Any administrative attempts to block M&A deals involving lower levels of market concentration cause efficiency concerns to gain critical importance. Increased scrutiny of M&A deals is not necessarily harmful to our economy. Some deals have the potential to lessen competition and should be stopped. Others, however, that are based on substantial synergies could actually increase competition. If the Agencies begin blocking deals at lower levels of market concentration, it is imperative that both the Agencies and the courts focus on sorting out the truly efficient transactions from the rest. Failure to do so would hinder the competitiveness of U.S. companies in concentrated markets.


105. 1997 REVISI0NS, supra note 2, § 1.51. Since this Article was originally drafted, the 2010 revised Guidelines have redefined “highly concentrated markets” to be those markets with a post-merger HHI concentration level of 2500 or more. 2010 REVISI0NS, supra note 6, § 5.3. The increased HHI figure of 2500, however, is still well below the market concentration levels at which the Agencies have historically instituted judicial proceedings.

106. Id.
Revisiting the grid from Part I of this Article helps to illustrate why, especially in the current economic and political climate, consistent judicial analysis of efficiencies is critical. Increased Agency enforcement activity would generate more preliminary injunction actions involving mergers in “medium” concentrated markets (that is, those markets with resulting HHI levels of 2,000–3,000). Currently, very few cases fall within these types of markets, so little precedent exists for merging parties to observe. Table 6 illustrates how these cases would be categorized in the grid analysis.

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<th>High (HHI &gt; 3,000)</th>
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If courts had consistently recognized efficiencies, irrespective of the underlying market concentration levels, corporations in these newly challenged transactions would have better visibility into the likelihood of their deals being blocked. While these organizations would still have to guess how the court would weigh the pro-competitive effects of projected efficiencies against the anticompetitive effects of increased concentration, they would at least have some sense
of which types of efficiencies are likely to be included in this analysis. Because courts have not been consistent in their recognition of efficiencies, however, merging parties now have to project not only how the court will balance perceived pro- and anticompetitive effects of their deal, but also whether the court is likely to recognize the claimed efficiencies as legitimate in the first place. This increased uncertainty raises the level of risk associated with organizations proceeding with the transaction.

The transparency and consistency of Section 7 determinations is essential for the U.S. merger and acquisition market to function most effectively. Although the vast majority of mergers proceed without raising antitrust issues, corporations in concentrated markets need a concrete understanding of what factors the Agencies and courts will consider and how they will weigh them. Without this understanding, organizations have great difficulty judging whether contemplated actions will run afoul of the Clayton Act.

III. THE IMPACT OF JUDICIAL TREATMENT OF EFFICIENCIES ON CORPORATE M&A NEGOTIATION DECISIONS

For over fifty years, law and economics scholars have analyzed antitrust policy using microeconomic market models and econometric tools. Law and economics, however, is not the only lens through which Section 7 Clayton Act cases can be viewed. This Part applies frameworks from the negotiation field to analyze how, in a regime of stricter antitrust enforcement, judicial treatment of the efficiency defense affects individual corporate M&A negotiation decisions. When considered in the aggregate, these individual corporate

107. Piraino, supra note 13, at 805 (“Without clear guidance, business executives are more likely to miscalculate, avoiding transactions that could promote the productivity of the American economy and pursuing mergers that are harmful to consumers.”).

108. Pitofsky, supra note 33, at 1413.

109. Piraino, supra note 13, at 786 (“The courts and agencies have developed a checklist of relevant factors to consider, but they have been unable to define when particular factors should be dispositive of a merger's legality. As a result, the courts and agencies have become more likely to miscalculate either by allowing anticompetitive mergers to proceed or by precluding transactions beneficial to consumers. This lack of clear guidance from the courts and agencies has left both practitioners and business executives confused as to the legality of particular mergers.”).

decisions affect the size, shape, and character of U.S. M&A activity in concentrated markets. This Part also demonstrates how inconsistent judicial treatment of efficiencies will reduce the volume of M&A deals and lead to the abandonment of those deals with the greatest potential to enhance competition through synergies and efficiencies.

A. Impact of Judicial Inconsistency on Volume of Deal Flow

A central question that all negotiators face when putting together deals is whether they should accept the other side's final offer. Is it a good deal? Will the negotiation be considered a success? Current negotiation theory suggests a variety of factors that negotiators can assess to determine the answer to this critical question.111 Does the deal satisfy the organization’s key interests? Have the negotiators explored all potential value-creating options? Is the agreement durable? One of the key questions to ask is what the organization will do if they do not come to an agreement. Of all of the possible alternatives to this particular deal, which one is most attractive? A negotiator’s best alternative to a negotiated agreement is referred to as their “BATNA.”112 Modern negotiation literature recommends that negotiators both identify their BATNA and take any feasible steps to improve it.113

Sometimes a negotiator’s BATNA will be concrete. For example, if I am negotiating the sale of my 2001 Subaru Outback to my local dealer, I may know that my best alternative to this deal is to sell the car to my neighbor for $3,600, assuming that my neighbor has agreed to such an arrangement. In other situations, such as settlement negotiations in litigation contexts, one’s BATNA can involve greater levels of uncertainty.114 When an entity’s BATNA involves uncertain events, many organizations use decision trees to aid in BATNA analysis, as they provide a logical way to map out and assess the likelihood and “predicted value” of different potential outcomes.115


114. See ROBERT H. MOOKIN, SCOTT R. PEPPET & ANDREW TULUMELLO, BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES 109–11 (2000) (discussing how decision trees can be used in litigation contexts to determine the expected value of a case).

115. For a practical explanation of how to use decision tree analysis to support negotiation choices, see MARJORIE CORNAR AARON, FINDING SETTLEMENT WITH NUMBERS, MAPS, AND TREES, in THE
BATNA and decision analysis tools provide an interesting lens through which to evaluate the impact of current judicial treatment of efficiency defense doctrine on individual corporate M&A negotiation decisions. A corporation contemplating an acquisition that potentially raises Section 7 issues must decide whether to move forward with the negotiated deal or to proceed with their BATNA (that is, either to take no action or to explore other potential transactions). In an M&A context, proceeding with the acquisition deal can involve significant uncertainty. Specifically, the corporation does not know whether the Agencies will take issue with the transaction and, if so, whether the court will issue a preliminary injunction blocking the deal.

Although the vast majority of M&A deals do not raise antitrust concerns, for those that do, this uncertainty can be devastating. Once a potential deal is announced, employees, customers, and shareholders are all generally anxious about the impact of the transaction. While the merging organizations can address some of the issues raised through proactive and consistent communication, they are not in a position to take unified action—such as announcing which managers will head new merged departments, issuing new pricing lists, or shutting down manufacturing facilities—until the transaction has closed.

The longer the waiting period extends—either due to an HSR second request or a trial regarding a preliminary injunction—the greater the risk the corporation faces of losing key employees, key customers, and general business momentum. Such distraction is a significant issue. Few managers and employees can maintain full focus on their normal business goals and tasks when massive...
organizational change looms in the future. For this reason, most transactions are abandoned if challenged by the government. Even worse, preliminary injunctions are generally considered to be “deal killers.”

Transparency is, therefore, critical. When assessing whether to move forward with a proposed deal, corporate negotiators need as much insight as possible as to how both the Agencies and the courts will evaluate their transaction. In recent years the Agencies have recognized this issue and have taken great strides to provide more information. As the case analysis in Part I illustrates however, courts have not.

When recognition of similar efficiencies varies depending upon the context of the case, the uncertainty facing corporate negotiators magnifies. This is particularly true if merging parties are involved in a transaction involving a “medium” concentrated market (that is, resulting HHI of 2,000–3,000) for which little judicial precedent exists. In addition to hypothesizing how the court might balance the anticompetitive and pro-competitive efficiencies of the deal, corporate negotiators also must guess whether the underlying efficiencies themselves will be recognized.

When comparing the specific acquisition deal on the table with their BATNA, corporate negotiators are logically going to discount the value of the potential deal based on all of the risk factors involved. The more opportunities that exist to derail a proposed deal, the greater the

120. Pitofsky, supra note 37, at 225.
121. In FTC v. CCC Holdings, the Court noted that “[t]he merging parties suggest they will abandon the merger if an injunction issues, in part because financing would be too difficult to maintain during the administrative process.” 605 F. Supp. 2d 26, 31 (D.D.C. 2009); see also Sullivan & Grimes, supra note 9, at 587 (when a preliminary injunction is issued “the parties to the transaction generally abandon it, choosing not to litigate further”).
122. See Deborah Platt Majoras, Chairman, Fed. Trade Comm’n, Reflections in An Election Year: Challenges in Antitrust Enforcement (Jan. 31, 2008), 2008 WL 699053, at *2 (“Time and again, business people have said to me, ‘We can handle rules; we just need as much certainty as possible about what they are.’ Each case, appropriately brought, represents another opportunity to explicate the rules.”) (emphasis added).
123. For example, in 2006 the FTC and DOJ released a new report, which explains current Agency frameworks and analysis and provide case examples. Fed. Trade Comm’n & U.S. DEP’T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES, at v (2006), available at http://www.usdoj.gov/atr/public/publications/215247.pdf (“Today, to provide greater transparency and foster deeper understanding regarding antitrust law enforcement, the Agencies jointly issue this Commentary on the Guidelines. The Commentary continues the Agencies’ ongoing efforts to increase the transparency of their decisionmaking processes.”). See also William E. Kovacic, Chairman, Fed. Trade Comm’n, COMPETITION POLICY IN THE EUROPEAN UNION AND THE UNITED STATES: CONVERGENCE OR DIVERGENCE?, 2008 WL 2311121, at *15 (June 2, 2008) (discussing how the United States has begun to emulate the E.U. system in providing more transparency to the public regarding why the FTC has chosen not to prosecute a particular case).
underlying value of the deal itself must be for corporate negotiators to move forward. The courts’ inconsistent recognition of efficiencies adds uncertainty to the picture. This uncertainty increases the risk associated with proceeding forward with the merger, thus affecting individual corporations’ decisions regarding planned transactions.\footnote{124} On an aggregate basis, corporations in concentrated markets will end up abandoning more deals than they otherwise would if courts were more consistent with their recognition of efficiency claims.\footnote{125} Therefore, some value-creating, competition-enhancing acquisitions will not take place.

Another way to conceptualize the impact of court-generated uncertainty on deal flow is through the use of Zone of Possible Agreement (“ZOPA”) analyses. Not all negotiations end in an agreement. Many barriers may prevent a deal, such as strategic behavior; information asymmetries; agency issues; and psychological barriers such as optimistic overconfidence, loss aversion, and reactive devaluation.\footnote{126}

In some cases a deal does not occur because each party has a BATNA that is stronger than any possible offer from the other side. In such cases, there is no ZOPA between the parties. Graphically, one can represent the ZOPA that exists in a negotiation as the area between each party’s reservation price—the price at which they are indifferent between the offer on the table and their BATNA.\footnote{127} Any deal to which the negotiators agree within these parameters is better for each of them than their respective BATNAs.

\footnote{124} Given the courts’ hostile and inconsistent treatment of efficiencies, some antitrust attorneys actually advise their clients to forgo trying to make their best efficiency case. \textit{See} Timothy Muris, Chairman, Fed. Trade Comm’n, Understanding Mergers: Strategy and Planning, Implementation, and Outcomes (Dec. 9, 2002), available at http://www.ftc.gov/speeches/muris/mergers021209.shtm. Such advice not only adds uncertainty to the decision tree, but actually makes certain branches impossible to reach.

\footnote{125} Attorneys are very focused on the question of whether they can “get [the] deal done.” Michael L. Weiner, \textit{Antitrust and Enhancing Efficiency}, \textit{ANTITRUST}, Summer 1997, at 4, 4. Inconsistent treatment of efficiencies makes it more difficult to answer this question affirmatively. \textit{Id}.


It is easiest to conceptualize a ZOPA if the negotiation focuses on only one variable, such as price. When other elements are added into the mix (for example, timing of deal or payment structure), it is more difficult to graphically illustrate the range of possible agreements that exist; conceptually, however, there is still a concrete range of options that are better than each party’s BATNA—assuming that a ZOPA exists.

Applying this analysis to Section 7 Clayton Act cases reveals the impact on M&A negotiations of courts’ inconsistent treatment of efficiencies. Part I of this Article highlighted how courts’ bimodal treatment of efficiency claims hinders corporations’ abilities to predict reasonably whether the court will recognize the projected synergies or savings from their proposed transaction. This lack of transparency increases the uncertainty associated with proposed mergers in concentrated markets, thus causing corporate negotiators to discount the value of potential deals vis-à-vis their BATNAs. The increased uncertainty effectively moves the two organizations’ reservation prices closer together, either reducing the size of, or potentially eliminating, the previously existing ZOPA. The net effect is to reduce the flow of M&A deals, in many cases eliminating transactions that could have helped to improve market competitiveness.

For example, if Corporation A is attempting to acquire Corporation B and there is significant uncertainty as to whether the deal will be blocked, Corporation A is not going to be willing to pay as much for Corporation B as it otherwise would. If it would be willing to pay $25 per share in a risk-free environment, it may only be willing to pay $22 per share given the uncertainties involved. Why the reduced price? It is because the uncertainty creates two real costs. The first cost is the risk that Corporation A will spend enormous time and energy on the proposed transaction, only to have it blocked. Even if there is only a small chance that this occurs, the share price that Corporation A is willing to offer must reflect the cost of this risk.

The second cost relates to the hidden expenses associated with uncertainty. Most obviously, a second HSR request or litigation surrounding a preliminary injunction involves additional transaction
costs. It also extends the time period between the public announcement of the deal and the closing. As discussed earlier, the longer the period of uncertainty, the greater the risk of negative impacts on employees, customers, and general business momentum. These factors must also be considered in the reservation price for the deal.

Corporation B faces similar issues. If in a risk-free environment it would be willing to accept payment of $20 per share for its stock, it is going to demand higher compensation when the level of uncertainty increases. Corporation B risks suffering lost transaction costs if the deal fails to go through. If the acquisition agreement includes any type of earn-out or contingent-price clause, it also risks making less on the deal if delays and uncertainty caused by second requests or litigation hurt the value of the ongoing business. Corporation B will, therefore, demand a higher sale price than otherwise necessary in a risk-free environment to move forward with the transaction. For example, it may demand $23 per share rather than $20 per share.

What impact do these uncertainties have on the deal? Given the original parameters in this hypothetical scenario, a fairly broad ZOPA existed between the two companies’ reservation prices of $25 per share and $20 per share. A number of deals could have been struck providing each organization with more value than their BATNA.

Once the cost of increased uncertainty is included in the analysis, however, the ZOPA effectively disappears. Corporation A is only willing to pay $22 per share while Corporation B is demanding at least $23 per share. There is no longer room for a deal. Each corporation is better off with its BATNA. The risks associated with the deal have eliminated the potential for a transaction that, absent the uncertainty, would have created considerable value for each side.

128. See SULLIVAN & GRIMES, supra note 9, at 583.
Obviously, all transactions involve risk. The hypothetical scenario’s analysis of a risk-free transaction is simplistic for the purpose of highlighting this fundamental dynamic. Conceptually, however, the ZOPA impact of moving from some risk to considerably more risk is similar to the impact described above. On an individual basis, it means that M&A negotiators will end up walking away from deals that otherwise could create value for both organizations.

On a macro level, each of these individual negotiator decisions, when aggregated, can lead to the sub-optimal functioning of M&A activity in concentrated markets. A broad swath of deals that would make U.S. companies more competitive will never occur. The uncertainty forces businesses to forego deals that, under a regime of more transparent and consistent court action, would have taken place and would have benefited both sides. The impact, therefore, is felt both in the increased number of deals the courts halt and—even more substantially—the increased number of value-creating deals that are never pursued due to fear that they might raise antitrust concerns.

B. Impact of Judicial Inconsistency on Character of Deal Flow

The traditional view of negotiation is best described as a zero-sum haggle.\textsuperscript{129} A simple case illustrates this point. Assume that Acme Corp. is looking for a particular piece of used industrial equipment needed for a new manufacturing facility; it discovers that Beta Inc., a local company, has the equipment at a nearby plant. If the only variable under negotiation is price, every dollar or concession that Acme wins, Beta loses. If Beta agrees to lower the price by $350,000, Acme gains because Beta has agreed to give up $350,000. This interaction is described as “zero-sum” due to the two entities’ collective inability to do anything more than decide how to allocate a fixed set of resources between themselves.\textsuperscript{130}

Over the last thirty years, scholars in the negotiation field have put forth an alternative model for describing and analyzing more complex negotiations. This integrative framework\textsuperscript{131} suggests that negotiators often perceive negotiations to be zero-sum that are in fact

\textsuperscript{129}See Fisher, Uey, & Patton, supra note 112, at 3–4 (illustrating such a traditional negotiation).

\textsuperscript{130}For a discussion of how negotiators are often trapped in a “zero-sum mindset,” see Mnookin, Peppet & Tulumello, supra note 114, at 168; Thompson, supra note 113, at 113.

not.\textsuperscript{132} Opportunities exist to use the negotiation process not only to split up a fixed set of resources, but also to see if ways exist for negotiators collectively to identify options that might enlarge the resources jointly available to them or to split the resources in a way that increases the value to each side.

For example, in the scenario described above, in addition to getting as much money for the equipment as possible, it is conceivable that the executives from Beta have a few other important interests. Beta may still have a few weeks of manufacturing runs scheduled in the nearby plant, so although it would like to finalize an agreement to sell the equipment as soon as possible, Beta would rather not transfer ownership of the machinery until the end of the month. Beta may also be facing some type of cash crisis. Although the total amount of money that Beta receives for the equipment is important, it may be willing to reduce the final sale price in order to obtain a cash advance.

Depending upon Acme’s situation, it may not be very costly for it to accommodate Beta on some of the things that Beta values. If Acme’s new manufacturing facility will not begin operations for a few weeks, Acme may be willing to postpone the actual transfer of ownership of the equipment, if it would receive a discount on the sale price. If the two companies can jointly craft an option that addresses this concern and which each would find superior to a simple straight sale, they have created value.\textsuperscript{133}

Similarly, it is possible that Acme’s cash flow situation may allow it to forward a portion of the sales price in advance as part of the deal. If this accommodation were possible, Acme may be willing to agree to this term as part of the overall deal, particularly if Beta would compensate Acme at a rate greater than it is currently earning in its investment accounts. By exploring creative options to address each of these issues—the date on which title of the equipment transfers and an advance of funds—the two companies have created value.

Recent negotiation literature provides a useful framework for identifying opportunities to create value when negotiating deals.\textsuperscript{134} Specifically, parties can look for creative options that (1) leverage

\textsuperscript{132} See BAZERMAN & NEALE, supra note 131, at 16–22.

\textsuperscript{133} Economists analyze potential deals by determining the total “utility” that each negotiator assigns to the various options available to them. Options that increase one party’s total utility without reducing the other party’s total utility create value as they enlarge the total utility points that can be divided between the parties. For an applied discussion of pareto optimality, see RAFFA, supra note 127, at 135–42.

economies of scale; (2) identify shared interests; (3) take advantage of differences in resources, capabilities, relative valuations, predictions, risk preferences, and time horizons; and (4) minimize transactions costs and moral hazards. These opportunities enable negotiators to maximize the potential value of a deal before it is distributed between the parties and to achieve the “win/win” to which people so often refer.

In the context of mergers and acquisitions, the value creation framework from the negotiation field provides a useful tool to analyze potential deals. If one looks at a potential acquisition or merger through a zero-sum bargaining lens, the negotiation dynamics appear quite simple. Putting aside agency and multi-party issues, the critical question appears to be how much Corporation A will pay for Corporation B’s stock or assets. Every dollar more that Corporation A pays is a dollar gained for Corporation B’s shareholders. Likewise, every dollar less that Corporation A pays comes out of the pockets of Corporation B’s shareholders.

Although distributional aspects of an M&A deal certainly exist, there are at least two points in time when sophisticated negotiators can move the discussion out of the zero-sum realm. The first is when the attorneys are negotiating the M&A agreement. In addition to designating a particular sales price, a well-drafted document also creates value by reducing the many transaction costs and risks of the deal. For example, well-crafted representations and warranties, accompanied by indemnification clauses, reduce the risk of

135. LAX & SEBENIUS, supra note 134, at 88–112.
136. Id.; Moffitt, supra note 127, at 176–81.
137. LAX & SEBENIUS, supra note 134, at 88–112; Moffitt, supra note 127, at 176–81.
139. These are obviously important factors that contribute to the overall negotiation dynamic. Agency issues arise when corporate officers and board members with differing interests are involved in the negotiation process. For an in-depth analysis of how principal/agent issues can affect negotiation dynamics, see MNOOKIN, PEPPET & TULUMELLO, supra note 114, at 69–91.
140. See STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 4–5 (2003) (“[P]eople hire transactional lawyers because they add value to the deal. This conception of the lawyer’s role rejects the zero sum game mentality. Instead, it claims that the lawyer makes everybody better off by increasing the size of the pie . . . . For the most part, lawyers increase the size of the pie by reducing transaction costs.”).
141. See BRUNER, supra note 17, at 40 (“The returns on even a mediocre deal can be enhanced for the buyer through artful deal design.”); Ronald J. Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 YALE L.J. 239, 255 (1984) (“I suggest that the tie between legal skills and transaction value is the business lawyer’s ability to create a transactional structure which reduces transaction costs and therefore results in more accurate asset pricing.”).
misinformation between sellers and buyers.142 Earn-out or contingent-pricing agreements help negotiators come to an agreement when buyers and sellers have differing forecasts regarding future performance.143 Covenants help ensure that the two parties’ incentives remain aligned during the period between the time when the merger agreement is negotiated and the transaction closes. Each of these structural agreements helps reduce risk and thus increases the value of the deal.

A second point in time when value creation occurs is much earlier in the deal-making process. If the transaction is analyzed from the point in time when Corporation A initially decided that it would like to explore an acquisition, the company can create additional value by identifying the best target acquisition.

When firms decide to make an acquisition, they usually do not immediately single out a particular firm to purchase. Instead, they generally engage in a lengthy and in-depth scanning and evaluation process to identify potential targets and assess their value.144 The acquirer is not simply looking to understand the intrinsic worth of potential targets. In the case of public companies, this calculation would be a fairly straightforward analysis, if one accepts market value as a reasonable proxy for stand-alone worth.

Instead, what companies are analyzing are potential synergies. If the two companies were to merge their operations, what synergies or efficiencies might be attained? How could they use their different resources, capabilities, relationships, and intangible assets to operate more effectively as one combined unit? Through the lens of negotiation theory, acquirers are engaging in one of the value creation phases of negotiation. They are attempting to “enlarge the pie” before they negotiate over how big of a piece each entity is going to get.

Applying the value creation framework from the negotiation literature to the M&A context highlights the numerous potential

142. See Gilson, supra note 141, at 280–82 (discussing the use of information-sharing and indemnification to add value to deals).

143. Id. at 263 (“[T]here is a familiar remedy, commonly called an ‘earnout’ or ‘contingent price’ deal, for this failure of the homogeneous-expectations assumption. It is intended, as a prominent practitioner has put it, to ‘bridge the negotiating gap between a seller who thinks his business is worth more than its historical earnings justify and a purchaser who hails from Missouri.’”) (quoting J. Freund, Anatomy of A Merger: Strategies and Techniques for Negotiating Corporate Acquisitions 205 (1975)); see also Bruner, supra note 17, at 34 (“Two studies have reported that the returns to buyers are higher when the payment is structured to be contingent on meeting future performance benchmarks.”).

144. See Gilson, supra note 141, at 271 (commenting on the information asymmetry that remains between a seller and a buyer even after the buyer’s thorough search for targets).
opportunities for M&A deals to create efficiencies. Some example places where value might be created include:

**Leverage Scale Economies**
- Leverage manufacturing economies
- Leverage existing corporate infrastructure by reducing combined staffing in general counsel’s office, human resources, IT, etc.
- Leverage purchasing economies (that is, qualifying for discounts due to combined quantities of goods purchased)
- Leverage promotional/marketing economies
- Leverage necessary R&D investments such as duplicative, expensive physical hardware

**Identify Shared Interests**
- Clear, consistent, proactive communication to stakeholders (that is, employees, customers, shareholders)
- Quick HSR Merger Review Process

**Take Advantage of Differences in Resources and Capabilities**
- Leverage each firm’s unique intellectual property
- Leverage strongest brands
- Leverage access to less expensive capital
- Leverage specialized manufacturing facilities
- Identify and promote strongest managers in each area
- Leverage unique R&D skills and capabilities

**Take Advantage of Differences in Relative Valuations**
- Certain resources (for example, established distribution channels) may be worth more to acquirer than target

**Take Advantage of Differences in Projections**
- Acquirer may have more optimistic view of target company market (for example, future profitability, growth rate)

**Take Advantage of Differences in Risk Preferences**
- If acquirer is larger and more diverse, acquisition may enable management to take on more risks (for example, if target business only represents one of many initiatives in a broad portfolio)

**Take Advantage of Differences in Time Horizons**
- If acquirer is a private company, acquisition may enable management to focus on long-term strategic goals, rather than short-term earnings per share targets

**Minimize Transaction Costs and Moral Hazards**
- Reduce time period of uncertainty
- Reduce potential litigation costs
- Take advantage of the merged entity’s ability to operate more efficiently by conducting business within the firm rather than in the marketplace

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145. There is a strong body of literature recognizing the significant synergies, or efficiencies, that mergers can create. See, e.g., Pitofsky, supra note 37, at 208; Gregory J. Werden, *An Economic Perspective on the Analysis of Merger Efficiencies*, ANTITRUST, Summer 1997, at 12, 12 (identifying a broad range of efficiencies generated by horizontal mergers).


147. Economists label this source of value “transactional efficiencies.” See Coate, supra note 8, at 191 (“The New Institutional Economist (Institutionalist) would accept the neoclassical analysis and add another layer of efficiencies defined by reductions in the transaction costs
Sophisticated businesses engage in this value creation process as they look for potential acquisition targets that best match their own organization’s skills, capabilities, people, and resources. In the end, the acquirer is likely to pay a considerable premium for the company it purchases; the only rational reason to do so is the belief that this “cost,” and more, can be recouped via synergies.\textsuperscript{148} If not, the transaction destroys shareholder value.

Only over time, as the acquirer learns more detailed information about the potential target, can it best assess the feasibility of possible synergies. Of course, not all competitive information can be shared—at least not directly or at early stages of the deal.\textsuperscript{149} Merging parties must be careful not to share confidential, competitive information directly (for example, pricing schedules) until the deal closes, or they risk violating antitrust rules.\textsuperscript{150} Much information can be shared; however, it takes time to identify and analyze it.

This value creation negotiation process where companies scan, identify, analyze, and discuss potential acquisition possibilities is extremely beneficial to the competitiveness of the U.S. economy. By exploring differences in capabilities, resources, risk preferences, and other opportunities for value creation, organizations are joining forces in ways that make them more efficient and effective competitors. This is market behavior that should be encouraged, particularly as domestic companies face continually stronger pressure from international entities. Only by allowing our domestic companies to position themselves in as competitive a structure as possible can they outperform their international peers.

The problem, however, is that many of the most important potential synergies—those that have the ability to create the greatest long-term value—are generally discounted in Section 7 merger

\textsuperscript{148} See GAUGHAN, supra note 16, at 124 (“The anticipated existence of synergistic benefits allows firms to incur the expenses of the acquisition process and still be able to afford to give target shareholders a premium for their shares. Synergy may allow the combined firm to appear to have a positive net acquisition value (NAV).”). Note, however, that acquisition premiums cannot always be justified by obtainable synergies and instead are sometimes better explained by managerial hubris. \textit{Id.} at 157–58.

\textsuperscript{149} See SULLIVAN & GRIMES, supra note 9, at 584. Some companies do use consultants and “clean teams” to share confidential information pre-close that is necessary for integration planning. \textit{See John Koob, Early Warnings on Culture Clash, MERGERS & ACQUISITIONS: DEAL MAKER’S J.}, July 2006, at 34, 34-37.

\textsuperscript{150} SULLIVAN & GRIMES, supra note 9, at 584.
What separates good companies from great, long-lasting organizations? It is generally not the three percent variable cost manufacturing efficiencies most easily recognized by the Agencies and the courts as true, verifiable efficiencies in a Section 7 challenge. Instead, it is other, more strategic capabilities such as R&D strength, innovation culture, product development skills, distributional relationships, developed intellectual property, customer market capabilities, or data mining skills. These capabilities are the building blocks of competitive organizations.

The FTC’s 1996 report, Anticipating the 21st Century: Competition Policy in the New High Tech, Global Marketplace, noted that in today’s markets, competition is not limited to price alone; instead organizations must compete on a variety of levels including product development, variety, speed, and innovation. In particular, the report emphasized that innovation efficiencies can contribute significantly to competitive dynamics.

Ideally, U.S. antitrust policy should recognize the strength of these valuable synergies and encourage domestic entities to leverage them to build as competitive of organizations as possible. The FTC report advises the Agencies to consider a broad range of efficiencies in merger analysis, including economies of scale and plant specialization, as well as distributional, promotional, transactional, managerial, and innovation efficiencies. Although the Agencies may have started to heed this advice, the courts, unfortunately, have not. Instead they
continue to generally ignore the pro-competitive impact of these important strategic synergies.

The private sector takes note of these rulings. In cases in which a merger challenge is feasible, corporate boards and executives are warier of basing their decision to merge on any long-term strategic efficiencies. Which deals are most likely to be abandoned? Unfortunately, those deals that are likely to be deemed too risky are exactly those that have the greatest potential to enhance competition.

IV. HOW COURTS SHOULD ANALYZE EFFICIENCIES: SOME PROPOSED GUIDELINES

Although courts have considered efficiencies in Section 7 cases for many years, judicial treatment of the topic has been inconsistent. This Part identifies four proposed guidelines to help courts analyze projected synergies in a more systematic fashion.

1. Evaluate efficiencies independently of market concentration. The grid in Part I of this Article reveals the strong link between underlying market concentration and recognized efficiencies. With the exception of a few hospital mergers, courts appear to only recognize efficiencies in cases that do not involve significant market concentration. In cases involving high market concentration, the courts discard similar types of efficiencies. It would be theoretically sound to find that a set of projected efficiencies justifies a merger in one context but not in another, due to the other anticompetitive effects of the deal, as long as this determination took place during the balancing portion of the analysis. Unfortunately this is not what is currently occurring in the courts. Different merger contexts appear to be influencing whether the courts recognize the efficiencies in the first place. The problem with the current judicial pattern is that it leads to inconsistent recognition of efficiencies, making it less transparent to merging parties how their transaction synergies will be treated. Courts need to begin decoupling their efficiency and concentration analysis.

2. Quantify efficiencies as a percentage of revenue. In determining the appropriate product and geographic markets, antitrust analysis focuses on the concept of “small but significant non-transitory price increases.” Could a hypothetical profit-maximizing

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158. The role of the courts in defining antitrust policy for the private sector is very important. See A. Douglas Melamed, Comments at the ABA Section of Antitrust Law Roundtable Discussion: Advice for the New Administration (Mar. 27, 2008), in ANTITRUST, Summer 2008, at 8, 11–12 (discussing the need for Agencies to define antitrust law by bringing cases).
159. 1997 REVISIONS, supra note 2, §§ 1.11, 1.21.
monopolist raise prices profitably?\textsuperscript{160} Although the pro-competitive benefit of quantitative efficiencies (that is, reduced variable or fixed costs) results in downward pressure on prices, courts never talk about the projected savings in terms that make this relationship concrete. Generally, they simply list the projected synergies in absolute terms (for example, $10 million per year). A useful data point for courts to consider in their analysis is the relationship between price and projected synergies. The impact on price of $10 million in annual cost savings is very different for a company with $100 million of revenue versus one with $10 billion of revenue. When balancing projected efficiencies against increased competition, it would be useful for courts to consider how large the recognized synergies are in relation to the merged entity’s projected revenue. Discussing this simple calculation in written decisions would make it easier for courts and merging parties to compare efficiency savings across transactions.

3. Recognize and weigh qualitative efficiencies in appropriate cases. One of the most difficult challenges facing judicial efficiency analysis is how to incorporate qualitative efficiencies (for example, enhanced R&D capabilities, ability to leverage existing brands) into the analysis. Although it can be difficult to measure these types of efficiencies, they often have the greatest potential to enhance market competition. Given these difficulties, this Article offers a few suggestions for how courts might consider these factors.

To start, it is appropriate to require merging parties to provide evidence of the potential pro-competitive effect of the qualitative synergies. It is not enough for merging parties to simply state that they will have enhanced R&D capabilities. What are the specific capabilities? How will they interact? Why isn’t this possible without the merger? Are there any specific examples of other companies that merged similar capabilities and saw a dramatic positive effect? What is the range of potential likely outcomes? There are a broad range of questions that merging parties should address, which will help to separate legitimate expectations from fanciful hopes.

Second, it is appropriate for courts to give greater weight to qualitative efficiencies in two specific contexts. The first is situations in which quantitative efficiencies alone almost justify the merger and the additional qualitative synergies tip the balance in favor of pro-competitive effects. The second scenario is situations in which the merger involves two organizations not currently holding one of the top two dominant market positions. In these cases, the merger could help these entities to better compete with current market leaders.

\textsuperscript{160} Id.
4. Defer consumer pass-through considerations until the balancing analysis. One of the three factors that courts use to discard efficiencies as non-cognizable is the issue of “consumer pass-through.” Will merging entities pass-through transaction-related efficiencies to consumers (either in the form of lower prices or improved products) or will the efficiencies simply result in increased corporate profits? Although it may seem like firms in concentrated industries would be less likely to pass through efficiencies to consumers, fundamental economic theory predicts otherwise. Firms are actually most likely to pass through efficiency benefits in concentrated markets due to the downward-facing demand curve that firms with large market share face. In other words, the increase in the quantity of goods these firms can expect to sell when they lower prices provides them with more profit than they would have earned by simply keeping prices constant. Despite this fact, courts continue to ask the black-and-white question of whether firms will pass through efficiencies as a rationale for completely discarding projected efficiencies from the competitive analysis. Rather than consider the question of consumer pass-through in the recognition analysis, courts should defer this issue.


162. See Yde & Vita, Reconsidering, supra note 161, at 741–46. Interestingly, in recent years, several economists have pointed out that in highly competitive markets, microeconomic theory predicts that efficiencies would not have ended up getting passed along to consumers as one might expect. See Yde & Vita, Fallacy, supra note 161, at 60 (discussing economists who have analyzed the pass-through effects of concentrated versus non-concentrated industries). In such scenarios (e.g., imagine a farmer selling wheat on a national market), the individual firm is considered a “price taker.” Since the firm can sell its entire output at the market price, it has no incentive to reduce prices based on efficiencies. Instead, it can capture the full efficiencies as profit. See Yde & Vita, Reconsidering, supra note 161, at 741–46.

163. FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 53 (D.D.C. 2002) ("Although the evidence presented by the defendants demonstrates that there could potentially be some positive results of the acquisition, the Court does not believe that these results outweigh the potential harm to the market that could result given the fact that there has not been sufficient evidence to establish how RCP will be able to compete effectively given the higher costs it will have to pay for its glassware, and why Libbey will not use this opportunity to raise its own prices.") (emphasis added); FTC v. Swedish Match, 131 F. Supp. 2d 151, 172 (D.D.C. 2000) ("However, the defendants’ evidence on efficiencies is not sufficient to overcome the presumption of illegality in this case. The savings that will be passed on to the consumers in the form of lower prices in this case is at best speculative.").
until the balancing analysis. From an economic perspective, there is no question that firms in concentrated markets have incentives to pass through efficiencies to consumers. The real question is what percentage of the savings will ultimately be passed through. This is a question of degree that should be addressed via modeling and the use of scenarios and ranges in the balancing analysis. Courts should stop using the consumer pass-through issue as a rationale to completely deny initial recognition of projected efficiencies.

CONCLUSION

Although courts give lip service to the value of merger-generated efficiencies, they consistently fail to recognize efficiencies in close Clayton Act cases. Over the last few decades, U.S. antitrust enforcement has grown increasingly lax. During this time frame, almost all mergers were approved—whether pro-competitive or not. This permissive policy masked the gap between how courts say they are analyzing the competitive effects of proposed deals and what they are in fact doing. However, a careful look at Section 7 judicial decisions reveals the lack of congruence between courts’ statements and their actions.

With the shift to more aggressive antitrust enforcement, this gap will present increasing problems for corporate negotiators in concentrated markets. Companies merge for a variety of reasons, often to capture strategic synergies. Although not all mergers create significant efficiencies, it is imperative that those that do are truly recognized and weighed in Section 7 competitive effects balancing analyses. Furthermore, when courts evaluate efficiencies, they should consider both the short-term and long-term positive impacts of a merger. It is often easiest for courts to focus on short-term cost savings, like reduced manufacturing costs. Many important longer-term benefits, however, such as research and development or innovation synergies, significantly contribute to the ability of U.S. companies to grow and develop their competitive skills and capabilities. Although these efficiencies are more difficult to quantify, courts must recognize them.
APPENDIX: CASE ANALYSIS OF MARKET CONCENTRATION & EFFICIENCIES LEVELS

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<th>PRODUCT MARKET / CONCENTRATION</th>
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<tr>
<td>FTC v. Staples (D.D.C. 1997)</td>
<td>High Product market: consumable office supplies sold through office supply superstores(^{164}) HHI ranges from 3,597 to 6,994 pre-merger; post-merger HHI ranges from 5,003 to 10,000; avg. HHI increase 2,715 points(^{165})</td>
<td>Low Efficiencies not verifiable,(^{166}) not merger specific,(^{167}) and not likely to be fully passed through to consumers(^{168})</td>
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<tr>
<td>FTC v. Swedish Match (D.D.C. 2000)</td>
<td>High Loose leaf chewing tobacco market(^{169}) HHI increased from 3,219 to 4,733(^{170})</td>
<td>Low Not verifiable and lack of consumer pass-through(^{171})</td>
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<tr>
<td>FTC v. Cardinal Health (D.D.C. 1998)</td>
<td>High Wholesale distribution market for prescription drugs(^{172}) HHI increased from 1,648 to 3,079(^{173})</td>
<td>Low Not merger-specific(^{174})</td>
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165. Id. at 1081.
166. See id. at 1089 ("[F]TC expert David Painter's testimony was compelling, and the Court finds, based primarily on Mr. Painter's testimony, that the defendants' cost savings estimates are unreliable . . . . The Court also finds that the defendants' projected 'Base Case' savings of $5 billion are in large part unverifiable, or at least the defendants failed to produce the necessary documentation for verification.").
167. See id. at 1090 ("[T]he evidence shows that the defendants did not accurately calculate which projected cost savings were merger specific and which were, in fact, not related to the merger . . . . In fact, Mr. Painter testified that, by his calculation, forty-three percent of the estimated savings are savings that Staples and Office Depot would likely have achieved as stand-alone entities.").
168. See id. ("In addition to the problems that the Court has with the efficiencies estimates themselves, the Court also finds that the defendants' projected pass through rate—the amount of the projected savings that the combined company expects to pass on to customers in the form of lower prices—is unrealistic.").
170. Id. at 167.
171. See id. at 171–72 ("[T]he Court ultimately finds that the defendants' efficiencies evidence is insufficient to rebut the presumption that the merger may substantially lessen competition . . . . The savings that will be passed on to the consumers in the form of lower prices in this case is at best speculative . . . . Without significantly more evidence to substantiate the savings purported in this case, and without greater clarity on the state of antitrust law in this circuit, the defendants are unable to rebut the presumption here with an efficiencies defense.").
173. Id. at 53.
174. See id. at 63 ("Weighing the evidence before it, this Court finds that the Defendants have sufficiently proved that significant efficiencies would likely result from the proposed mergers . . . . However, this Court finds that evidence presented by the FTC strongly suggests that much of the savings anticipated from the mergers could also be achieved through continued competition in the wholesale industry.").
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<td>FTC v. University Health (11th Cir. 1991)</td>
<td>High Market is provision of inpatient services by acute care hospitals(^{176}) HHI increased by over 630 points to approximately 3,200(^{176})</td>
<td>Low Not verifiable and lack of consumer pass-through(^{177})</td>
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<tr>
<td>FTC v. PPG Industries (D.C. Cir. 1986)</td>
<td>High “High technology” aircraft transparencies market(^{178}) Broader transparencies market had HHI of 1,943; merger would increase this to 3,295(^{179})</td>
<td>Low Efficiencies not merger-specific(^{180})</td>
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<tr>
<td>FTC v. Alliant Techsystems (D.D.C. 1992)</td>
<td>High Products and services involved in the manufacture and related servicing of all current 120 mm tank ammunition rounds and in the development of advanced tactical rounds(^{181}) Merger-to-monopoly; HHI would be 10,000(^{182})</td>
<td>Low Efficiencies small and not verifiable(^{183})</td>
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<tr>
<td>FTC v. Libbey (D.D.C. 2002)</td>
<td>High Food service glassware market(^{184}) HHI projected to increase from 5,251 to 6,241(^{185})</td>
<td>Low Lack of consumer pass-through(^{186})</td>
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176. Id. at 1211 n.12.
177. See id. at 1222 (“Here, however, the appellees have failed to introduce sufficient evidence to demonstrate that their transaction would yield any efficiencies, and the district court’s factual finding to the contrary is clearly erroneous.”); id. at 1223 (“We hold that a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers . . . The appellees here have not presented sufficient evidence to support their claim that the intended acquisition would generate efficiencies benefiting consumers.”).
179. Id. at 1502–03.
180. See id. at 1508 (“Finally the district court found that a merger of PPG and Swedlow might lead to the development of more sophisticated materials and/or transparencies . . . . The gains to be derived from technological cooperation are not exclusive to a PPG-Swedlow marriage; cooperation with other market participants could yield similar results without causing the same market concentration.”).
182. Id. at 15–16. This case is interesting as the defendants’ proposed merger was a direct response to the Army’s decision to competitively bid a five-year, sole-source contract in the 120 mm market. Whether the defendants merged or the Army continued forward with its competitive bidding process, there was ultimately only going to be one supplier left in the market. Id. at 15.
183. Id. at 21 (“Defendants’ concerns regarding the risks of transferring technology to cost, delay, and quality are speculative at best . . . Defendants furthermore fail to consider the not insignificant restructuring and transaction costs that would result from the merger.”).
185. Id. at 50–51.
186. See id. at 53 (“Although the evidence presented by the defendants demonstrates that there could potentially be some positive results of the acquisition, the Court does not believe that those results outweigh the potential harm to the market that could result given the fact that there has not been sufficient evidence to establish how RCP will be able to compete effectively...”)
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<td>U.S. v. United Tote (Del. 1991)</td>
<td>High North American totalisator systems and services for pari-mutuel wagering (e.g., horse betting)(^\text{187}) HHI projected to increase from 3,940 to 4,640(^\text{188})</td>
<td>Low Efficiencies not merger-specific; consumer pass-through concerns(^\text{189})</td>
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<tr>
<td>FTC v. H.J. Heinz Co. (D.C. Cir. 2001)</td>
<td>High Jarred baby food market(^\text{190}) HHI projected to increase from 4,775 to 5,285(^\text{191})</td>
<td>Low Efficiencies not merger-specific(^\text{192}) and not verifiable(^\text{193})</td>
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<tr>
<td>FTC v. CCC Holdings, Inc. (D.C. Cir. 2009)</td>
<td>High Partial loss and total loss software market for insurance claims(^\text{194}) HHI in Estimatics (partial loss software) market would increase from 3,650 to 5,685(^\text{195}) HHI in Total Loss Valuation software market would increase from 4,900 to 5,460(^\text{196})</td>
<td>Low Efficiencies not verifiable, consumer pass-through concerns, and merger specificity issues(^\text{197})</td>
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Given the higher costs it will have to pay for its glassware, and why Libbey will not use this opportunity to raise its own prices." (emphasis added).


188. Id.

189. See id. at 1084–85 ("With regard to financing, unlike International Harvester, United Tote has failed to show that the merger is necessary to acquire the financial and service capabilities it needs . . . . The Court's finding is guided, in part, by the reality that even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public.").


191. Id. at 716.

192. See id. at 721–22 ("Finally, and as the district court recognized, the asserted efficiencies must be 'merger-specific' to be cognizable as a defense. That is, they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor. Yet the district court never explained why Heinz could not achieve the kind of efficiencies urged without a merger. As noted, the principal merger benefit asserted for Heinz is the acquisition of Beech-Nut's better recipes, which will allegedly make its product more attractive and permit expanded sales at prices lower than those charged by Beech-Nut, which produces at an inefficient plant. Yet neither the district court nor the appellees addressed the question whether Heinz could obtain the benefit of better recipes by investing more money in product development and promotion – say, by an amount less than the amount Heinz would spend to acquire Beech-Nut."). Note that the court assumed that distribution efficiencies are a function of scale and not capabilities. See id. at 721 n.19 ("In addition, the district court described Heinz's distribution network as much more efficient than Beech-Nut's. It failed to find, however, a significant diseconomy of scale in distribution from which either Heinz or Beech-Nut suffers. In other words, although Beech-Nut has an inefficient distribution system, it can make that system more efficient without merger. Heinz's own efficient distribution network illustrates that a firm the size of Beech-Nut does not need to merger in order to attain an efficient distribution system.").

193. See id. at 723 ("In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC's showing was rebutted by an innovation defense.").


195. Id. at 45.

196. Id. at 46.


197. See id. at 73 (“The Defendants have not demonstrated here that their efficiencies are verifiable.”).

198. See id. at 74 (“Even assuming arguendo that the Defendants will achieve significant cost savings in a timely manner, there is no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers to offset the potential for increased prices . . . . Second, while reducing the costs of doing business provides several advantages for the merged firm, these advantages could show up in higher profits instead of benefiting customers or competition. Mr. Ramamurthy admits that CCC will give its shareholders much of any savings. Andrew Balbirer, similarly stated that the synergies from the deal would either be invested in new products or go to company profits. Likewise, Mr. Sun of Mitchell stated that the cost savings are likely to go to ‘building value added products’ rather than lowering consumer costs.”) (citations omitted).

199. See id. at 75 (“Furthermore, there is little evidence that these promises of increased R & D spending are merger-specific.”).


201. Id. at 1280.

202. Id.

203. Id.

204. See id. at 1288–89 (“As to qualitative benefits to consumers, the defendants proclaim that the merger of SAH and RMH will provide the Rockford community with a first class regional tertiary referral center that will eventually rival tertiary referral centers in Madison, Chicago, Milwaukee and Rochester. The defendants promise that the number, depth, and quality of services at the hospital will improve . . . . The court finds the defendants’ intention to create a state-of-the-art tertiary referral center and all its corresponding benefits in quality and community development as irrelevant for the present § 7 inquiry.”).

205. See id. at 1289–90 (“Thus, the one-sided study projects the savings derived from the merger and none of the expenses . . . . In short, the study does not reflect the net savings of the merger; only the cost savings . . . . Some of the savings in [the nine identified areas of the defendants’ business] would occur not so much because of the economics effected by the merger, but from a drop in production.”); id. at 1290 n.21 (“Another aspect of the defendants’ savings in the area of overhead that is troubling is the lack of information on the input/output relationship in the area of laboratory/pathology fees. Therefore, assumptions as to these savings are impossible to verify.”).

206. See id. at 1291 (“Moreover, monopoly rents could far outweigh the savings presented, particularly in light of the fact that much of the savings cited by the defendants were not clearly and convincingly generated by the merger. Large amounts of savings could be achieved independent of a merger through alternative action.”).


208. Id. at 1035.

209. Id. (finding the evidence of true efficiencies was “wanting”).
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210. Id. (“Defendants have not made the necessary showing that efficiencies would result and that they would lead to benefits for consumers in the relevant market. Not only is the evidence of true efficiencies wanting, but the profits such efficiencies would generate would be unlikely to affect the American customer.”).


212. Id. at 1294.

213. Id.

214. Id. at 1301 (“In sum, the Court is persuaded that the proposed merger would result in significant efficiencies, in the form of capital expenditure avoidance and operating efficiencies, totaling in excess of $100 million. This is, by any account, a substantial amount, and represents savings that would, in view of defendant’s nonprofit status and the Community Commitment, invariably be passed on to consumers.”).


216. Id. at 1144.

217. Id. at 1145–46 (“Elders and ICM’s first argument [regarding increased efficiencies] fails to persuade this court because it rests heavily on the assumption that eastern and western geographic markets for prime products exist.”).

218. Id. at 1146 (“Even assuming Elders is unable to efficiently operate the Lincoln mill, it does not follow that competition in the relevant geographic market will be enhanced by the challenged acquisition. Rather than lower prices for consumers, the likely result of the Lincoln acquisition will be greater mill profitability.”).


220. Id. at 1130.

221. Id. at 1133 (“Moreover, even assuming these efficiency savings do result, the Court is not convinced that defendants will invariably pass these savings on to consumers. As the State queried, ‘And, most importantly, is it really true that the new firm can achieve $50 million in savings after servicing the debt they assumed in leverage [sic] this $2.5 billion buy-out?’ ”).

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223. *Id.* at 128 (“Based on reserves, then, the proposed transaction may raise significant competitive concerns—although just barely.”).

224. *Id.* at 151 (“Of this amount, $27.4 million is general and administrative expenses, which mr. [sic] Lange himself acknowledges is not merger-specific because ‘another coal company’ without an adjacent mine could achieve it. This leaves $107.4 million in claimed merger-specific savings from the combination. Even as to that remaining amount, however, defendants have not made a strong case on efficiencies. Plaintiffs have systematically pointed out deficiencies in defendants’ estimates of efficiencies and shown that defendants have not been able to quantify with precision the savings netted by the proposed transaction. Some of the efficiencies identified by defendants are not merger-specific while others are undercut or reduced on the basis of the evidence.”); *id.* at 153 (“The realized efficiencies are more likely to be in the $35 to $50 million, rather than the $130 to $140 million, range over the five year period from 2004 through 2008.”).


226. *Id.* at *28 (“With the inclusion of the various firms who do or could supply Albuquerque after a small but significant price increase, the postmerger combined market share of Western and Giant is 5.7 percent, which corresponds with a change in HHI of only fifteen. While a change of fifteen would not be significant, the Court does not believe that it should include all the Gulf Coast refiners, because the record does not establish that all refiners are actually or currently sending product to the relevant market. The potential is there, but the market remains concentrated. Both parties’ experts admitted the market is concentrated, but it appears that most such markets are similarly concentrated. Thus, the Court will find that the FTC has made a *prima facie* case under the *Merger Guidelines*, but it is a weak *prima facie* case.”).

227. *Id.* at *49 (“The Court is also convinced that there will be efficiencies resulting from the merger.”); *id.* at *57 (“The efficiencies of the merger have not played a determinative role in this case.”).


229. *Id.* at 673.

230. *Id.* at 674 (“Significant efficiencies will be realized by Country Lake’s acquisition of Superior. This acquisition will enable Country Lake to increase its capacity substantially. This will result in lower plant and transportation costs and other savings. At minimum, these efficiencies will enable Country Lake to compete head-to-head with Marigold, the top-selling dairy in the [Minneapolis-St. Paul Metropolitan Statistical Area].”).

232. Id.

233. Id. at 145 (“Here, the Court finds that the merged entity will not have an undue share of the relevant product and geographic markets.”). Note that in addition to the lack of market concentration, the court did explicitly state that other factors also led them to believe that the risk of anticompetitive effects was minimal. Id. (“In sum, the evidence in this case indicates that, in the event the merger is consummated, it is unlikely that there will be a price increase . . . . In making this determination, the Court must balance the reduced competition and increased market share of the merged hospital against the suitable available alternatives, the multi-diverse economic forces that are driving down hospital populations and the efficiencies to be gained from such a merger.”). While these factors may have contributed to the court’s ultimate judgment that anticompetitive effects were unlikely, the fact that no high market concentration was proven was critical to this determination.

234. Id. at 148–49 (“Reviewing the testimony as to the claimed efficiencies in its totality, the Court finds the proposed merger will result in significant efficiencies in the form of annual operating savings in expenses in the sum of approximately 25 to 30 million dollars per year. In addition, there will be some capital avoidance in an unknown amount.”).

235. Id. at 149 (“Therefore, the Court finds that, with reasonable certainty, the ‘efficiencies’ gained in this merger will ultimately result in benefits to the consumers.” (citing hospitals’ agreement with New York Attorney General to pass on to the community cost savings equal to $100 million during five-year period)).


237. Id. at 848.

238. Id. at 841, 849.

239. Id. at 849.

240. Id. (“Based on Roanoke Memorial’s serious need to expand and Community’s need for more patients, they have found various ways in which more efficient operations can save money and thereby enable them to offer their services more competitively than ever, to patients’ benefit.”); id. at 846 (“In conclusion, the court finds that the planned merger would probably improve the quality of health care in western Virginia and reduce its cost and will strengthen competition between the two large hospitals that would remain in the Roanoke area.”).


242. Id. at 1053 (“The question before us is whether the FTC provided sufficient evidence that the proposed merger will result in the merged entity possessing market power within the relevant geographic market. Because we conclude that the FTC produced insufficient evidence of a well-defined relevant geographic market, we find that it did not show that the merged entity will possess such market power. The FTC’s failure to prove its relevant geographic market is fatal to its motion for injunctive relief.”).
243. *Id.* at 1054–55 (“We further find that although Tenet’s efficiencies defense may have been properly rejected by the district court, the district court should nonetheless have considered evidence of enhanced efficiency in the context of the competitive effects of the merger. The evidence shows that a hospital that is larger and more efficient than Lucy Lee or Doctors’ Regional will provide better medical care than either of those hospitals could separately. The merged entity will be able to attract more highly qualified physicians and specialists and to offer integrated delivery and some tertiary care . . . . The evidence shows that the merged entity may well enhance competition in the greater Southeast Missouri area.”).


245. *Id.* at 1108.

246. *Id.*

247. *Id.* at 1175 (“The court finds Oracle’s evidence on the claimed cost-savings efficiency to be flawed and unverifiable. Catz and Ellison’s personal estimations regarding the potential cost-savings to Oracle are much too speculative to be afforded credibility. Oracle’s efficiency defense based upon future innovations (e.g., the superset product) was not verified by internal documents. Oracle presented no evidence regarding the functionality of characteristics the innovative product will contain, nor any evidence regarding its date of availability. Accordingly, both claimed efficiencies are much too vague and unreliable to rebut a showing of anticompetitive effects.”).


249. *Id.* at 987.

250. *Id.* (“The defendants have failed to meet this burden in several significant respects: (1) a merger is not required to achieve many of the efficiencies; (2) implementation of the steps necessary to achieve the efficiencies is highly speculative; and (3) the Gallagher Report overstates the efficiencies which can be achieved.”).